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Development Solutions in a Post-Consensus World

Leroy Eakin IV/ EKNLER001

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This work has not been previously submitted in whole, or in part, for the award of any degree. It is my own work. Each significant contribution to, and quotation in, this dissertation from the work, or works, of other people has been attributed, and has been cited and referenced.

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ABSTRACT

The following paper investigates the current paradigm for economic development in Sub-Saharan Africa. Following a review of recent literature in international political economy, the author argues the present system is a result of national self-interest in the North, rather than being the best program for development in the South. A critical analysis of the popular Washington Consensus strategy is provided. The author contends these policies underutilize recent advances in the theory of economic development as well as international political economy.

Empirical data is used throughout the paper to support the argument. While most of the data comes from leading researchers in the field, a portion is based on primary research into the statements and documents of government officials, international organizations, and non-governmental entities. A case study is used to illustrate the benefits of new theories for growth, as well as to identify the critical determinants of economic development.

The author concludes that reforms are needed to improve the economic, political and social development of Sub-Saharan Africa. Policies would improve by properly pacing and sequencing the macroeconomic reforms of the Washington Consensus, building national unity and domestic institutions, focusing on productivity growth and agriculture and utilizing African intellectual and political contributions.

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CHAPTER ONE: THEORY AND PRACTICE OF DEVELOPMENT IN SUB-SAHARAN AFRICA

After fifty years and nearly \$1 trillion in finance, the record of development initiatives throughout the world is mixed, at best. Development programs, often tied to extensive aid packages from international donors or finance organizations, have shown little success, despite the massive effort. In Africa alone there are an estimated 50,000 to 100,000 foreign experts involved in development activities.¹ And yet, between the early 1960s and the late 1980s there was no growth in average per capita income for the continent.²

With nearly 45% of the world's population (2.8 billion people) living on less than \$2 a day and the division between rich and poor countries growing every day, it is hard to think of a more pressing issue in international political economy than developmental economics. It spans every major arena of interstate relations: security, economic prosperity (for both the developed and developing countries), diplomacy, cultural enrichment, and human development.

Despite its importance, however, developmental economics has produced few answers and many questions in the last fifty years. One of the only answers we have, in fact, is that what has been tried so far has not been working.³

After all the attention, hard work and investment, Sub-Saharan Africa, by far the poorest region in the world and the focus of this paper, is worse off today than it was forty years ago. The region remains isolated from the globalizing economy. During the 1990s, it accounted for less than 1% of world trade, despite having

¹ Benno Ndulu, Nicolas van de Walle and contributors, *Agenda for Africa's Economic Renewal* (Overseas Development Council: Washington DC, 1996), p.11.

² Carol Lancaster, *Aid to Africa: So Much to Do, So Little Done* (The University of Chicago Press: Chicago, Illinois, 1999), p.19.

approximately 12% of world population. Moreover, the continent is mired in poverty and debt. In recent years, in fact, there has been a net outflow of resources from Africa to its creditors. By one account this deficit is nearly two billion US dollars: Africa spends \$14.5 billion each year repaying debts and only gets \$12.7 billion in official aid.⁴ To clarify, the poorest region in the world is at present subsidizing the world's richest nations. Clearly, something has gone terribly wrong. What can be done? Why have most countries in Sub-Saharan Africa not progressed further? And, more fundamentally, what causes countries to develop?

This paper adds to the growing chorus of dissent in development. It argues that the current situation is untenable. Developing countries are becoming increasingly frustrated by their continued poverty, and the industrialized nations are growing weary of continually remitting large amounts of money seemingly without any positive result.

After an introduction to the issues, my approach and the development literature, a more thorough critique of the current development system is given. While it should be stated that many of these criticisms have been made before, the continued preeminence of the Washington Consensus in official development policy makes further discussion, and illustration of the policy's shortcomings, relevant and necessary. An alternative development strategy, following the recent progression of development theory, concludes Chapter One.

The second chapter is devoted to a more in depth analysis through the use of a case study. The theory and practice of development in South Africa is examined as a proving ground for policies in a stable political environment.

INTERNATIONAL POLITICAL ECONOMY AND THE EVOLUTION OF DEVELOPMENT THEORY

This paper approaches the above questions from an international political economy approach. Before the analysis, it is appropriate to define the relevant theoretical parameters as well as review previous work.

³ At least to the degree many pioneers in the field had hoped. See discussion in Chapter One of Lancaster (p.1-13) as well as *Frontiers of Development Economics: The Future in Perspective* edited by Gerald M. Meier and Joseph E. Stiglitz, (Oxford University Press: New York, 2001).

⁴ DATA Resources. Online <http://www.datadata.org>.

I take my working definition of political economy from Robert Gilpin, who differentiates political economy from neoclassical economics in the following way,

“Whereas neoclassical economists believe that the market is autonomous, self-regulating, and governed by its own laws, almost all political economists assume that markets are embedded in larger sociopolitical structures that determine to a considerable extent the role and functioning of markets in social and political affairs and that the social, political, and cultural environment significantly influences the purpose of economic activities and determines the boundaries within which markets necessarily must function.”⁵

Unlike traditional neoclassical economists, IPE does not treat governments as exogenous variables. Gilpin goes on to argue that IPE is further differentiated as a result of the questions pursued. Rather than focusing on efficiency, IPE is more interested in political questions such as the distribution of gains from market activities.

As the reader will see below, I follow in the belief that markets develop out of, and for the purpose of, sociopolitical structures. This paper follows in the IPE tradition by, in Gilpin’s words, focusing on the world economy’s “impact on the power, values and political autonomy of national societies.”⁶ Much attention is given to the current inability (as a result of global forces) of many Sub-Saharan African states to determine domestic economic policies.

Of course, this leads to the seemingly ubiquitous issue of globalization, a topic that is important to both the study of international political economy generally and this paper specifically. As my paper makes certain assumptions about both the nature of international relations and the state of globalization some attention to these topics is important.

Like Robert Schrire, I believe globalization is an often overused and nebulous concept.⁷ Regularly cited for a multitude of problems entirely unrelated to the increasing interconnectedness of the world economy, globalization has become an easy target, in part because of this difficulty in establishing an accessible definition.

⁵ Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton University Press: Princeton, New Jersey, 2001), p.74.

⁶ Gilpin, p.77.

My focus on globalization will be on economic globalization, by which I mean the transition from nation-state based economies, to a system in which all agents have access to a common pool of resources.⁸ In a fully globalized world, therefore, there would be no differentiation among domestic economies; all economic agents (individuals, firms, governments) would have equal access to the essential economic inputs (capital, labor and technology).

Using this definition, I follow many in arguing that we are far from a fully globalized world. Most of world production is produced for and sold to local markets. Most capital remains state based. The frequently cited statistic that trade, investment and financial flows were actually greater in size in the late 19th century, relative to the size of the international economy, than they are today gives additional support to this position.

However, I disagree with Gilpin and many others who claim that economic globalization is not already a powerful force in the global economy. While acknowledging the comparative statistics from previous eras, I would argue that the breadth, if not the depth of globalization, has substantially altered the global economy.

Today, globalized resources of capital, technology and labor reach across many different industries. Global forces actively shape the domestic economic climate of developing countries, and in many cases, distort these smaller economies in negative ways. Across a wide array of sectors, from textiles and agriculture to manufacturing and technology, globalization can actively inhibit domestic growth in the developing world more than ever before.

If you don't see globalization as a pervasive, omnipresent microeconomic issue in the developing world, ask yourself, what obstacles face a local entrepreneur trying to create a new soft drink in the developing world? In a world where Coca Cola Company annually sells 1,122,000,000 unit cases in Africa alone, I believe the

⁷ Robert Schrire, "Globalization and the State: A View From the South," Unpublished draft, University of Cape Town, 2001.

⁸ The 'common resource pool' concept is attributable to Michael Veseth, "*Selling Globalization*" (London: Lynne Rienner, 1998). As quoted in Schrire, p.1.

globalization of the last twenty years has a major impact on everyday economic activity throughout the developing world.⁹

The Coca Cola illustration leads to my next argument. As Schrire has illustrated, the “idea of a non-state transnational corporation is a myth and a dangerous one at that.”¹⁰ Corporations remain firmly established in nation-states. The mutually beneficial relationship prevents the establishment of any truly transnational corporation. Corporations share their country values, and benefit from their government’s ability to open foreign markets and receive favorable terms of trade. (As a result, it should not be surprising that a majority of major international corporations are located in politically powerful states such as the US, UK, Germany and Japan.) Countries, in turn, receive the additional tax revenue, employment, foreign exchange and other benefits from being the home country to an international firm. In this view, corporations are not the drivers of globalization, as protestors insist, but rather they are extensions of national government interests.

This approach, as the reader will see, follows Robert Gilpin in assessing international political economy from a state-centric realist perspective. Without any normative claim, I believe states are the primary actors in an anarchic system of international affairs. Interstate relations are driven by national interest, interpreted here as economic nationalism, or the neomercantilist model. Here, again, I follow Gilpin in his interpretation of mercantilism; namely, “by mercantilism I mean the attempt of governments to manipulate economic arrangements in order to maximize their own interests, whether or not this is at the expense of others.”¹¹

One point of clarification is needed, however. My support of a state-based realist approach may appear incongruous with the lengthy discussion below of international institutions and their powerful influence on developing countries. I do not believe states are the only important actors, merely that they are the primary actors. In this view, the World Bank and the IMF are examples of state involvement by other means. When this paper refers to IMF pressure upon developing nations, it is assumed that the IMF is acting in lieu of industrialized nations (read: US, and to a

⁹ Figure calculated from information in the “Coca Cola Annual Report 2002.” Coke currently has a 41% share of the non-alcoholic beverage market in South and East Africa and world net operating revenues of \$19.56 billion. Online. <http://www.cocacola.com>.

¹⁰ Schrire, p.14.

¹¹ Gilpin, “Three Models of the Future,” *International Organization*, Winter 1975, p.37-60.

lesser extent EU and Japan). I believe this approach, though admittedly simplified, is defensible by appealing to the voting power of individual nations within the IMF/World Bank decision-making process. Because of the weighting system, the US is the only country with effective veto power. As numerous examples have shown, the US has the capacity to not only shape World Bank/IMF policy, but also reject other countries' proposals for IMF/World Bank action.

This state-centric realist perspective coincides with my approach to globalization in that I believe economic and technical forces have not replaced national power in shaping the world economy. As I argue throughout the paper, national governments repeatedly use political power to influence the international markets. There is not such thing as 'free trade' in existence today, as markets are never left alone to the extent that neoliberalism would demand.

In fact, it is precisely because I believe the world economic system is a product of rampant economic nationalism that this paper should be written. Currently, as I seek to establish below, the wealthy/powerful states are shaping the nature of the emerging world order and defining the rules of engagement. As such, the terms of inclusion in the world economy increasingly favor the wealthy.¹² However, there is capacity for change.

As Schrire notes, globalization is a process, not an outcome. The end-point is not predetermined, nor has it been reached. Because we are far from a fully globalized world, there remains an opportunity to reform the process; to make it a more equity and inclusive process that provides for the betterment of all of humanity, not just the wealthy. This paper is predicated on that notion.

The Origins of Development Theory

At first appearance, it appears contradictory to move from a discussion of how national self-interest determines international economic relations to an analysis of foreign aid and development programs. Shouldn't self-interested states try to prevent, or at least remain indifferent to, the advancement of lesser-developed countries?

¹² Schrire, p.8.

This view assumes a zero-sum view of economic development that I believe is discredited by modern economics (though not discarded by many politicians). All nations have a vested interest in equitable growth of the world economy. Wealthy nations have both economic interests, such as developing foreign markets for exports, promoting healthy macroeconomic environments for investment, and absorbing the comparative advantages of cheaper foreign labor through increased imports; as well as political interests such as global peace and security. The tremendous disparity in wealth between the industrialized and developing worlds that has resulted in part from past failures in development strategies has certainly contributed to current international political concerns such as global terrorism and environmental degradation. As political, social, cultural and economic globalization continues, all nations have a long-term interest in promoting more equitable development.

Nevertheless, as I argue below, one of the reasons for the failure of development theory has been its' emphasis on promoting the narrow self-interest of the industrialized world. From the strategic allocation of foreign aid budgets to the neoliberal prescriptions of open markets, many of the measures captured under 'aid' or 'development' actually benefit the wealthy nations rather than the poor. By deepening the divide between the North and the South, it is my contention that these policies are self-defeating and should be reformed.

Goals of Development

Before evaluating development theory and practice, we must define what we mean by development. Surprisingly perhaps, development is a very elusive term and has meant many different things over the last fifty years (See Appendix A).

When first conceived of, developmental economists had a very narrow definition of development: the rise of basic economic indicators such as gross national product, or per capita GNP. At the time, it was strictly economists that were contributing to the theories of development so the parameters seemed clear. As countries developed, people got richer. Virtually no attention was given to the distribution of wealth or the political and social context in developing countries.

As more notice was given to the field by sociologists, political scientists and environmentalists, this definition began to expand. Led by the UN, nonmonetary

indicators such as the Human Development Index became the standard appraisal of development. Taking into account broader measures such as literacy rates, political freedoms and life expectancy, these measures shifted the goals of development. Not only were the economic priorities of efficiency and GNP growth assessed, but also the political qualities of distributional impact and democracy were relevant. As the cliché says, development was given a human face.

While the trend has continued to a more expansive definition of development, it was the resurgence of the World Bank that pushed the goals of development toward the elimination of poverty. Levels of poverty became important measures of comparative development during the 1970s and into the 1980s.

Today, the evolving definition continues. While poverty levels remain one of the more tangible measures, developmental economists increasingly approach development using a wide range of 'soft' indicators. Following Amartya Sen's influential book *Development as Freedom*, new focus has been given to the level of political and economic freedom available to people. Development is defined as the ability to choose how to live "without being restrained by lack of income, health or opportunity."¹³

Sources of Growth

As the goals of development have steadily changed over the past fifty years, so too has the proposed sources of growth. Macroeconomic growth theory has moved through three major phases in the last half-century (See Appendix A), though, discouragingly, many people still hold on to past theories as a panacea for the world's problems.

Immediately following World War II, Evsey Domar published an article on economic growth entitled "Capital Expansion, Rate of Growth, and Employment." His conclusions, though intended only for short-term recessions in the industrialized

¹³ Nicholas Thompson and Scott Thompson, *The Baobab and the Mango Tree: Lessons about Development, African and Asian Contrasts* (Zed Books, London, 2000), p.81.

world, were to become the foundation of development theory for the next fifty years (and unfortunately, maybe longer).¹⁴

Perhaps because of its simplicity, the Harrod-Domar model (Harrod was a British economist) is the most widely applied growth model in economic history.¹⁵ It states that GDP growth is proportional to investment: in order to increase growth, simply increase the share of investment spending in GDP.

At the time, development economists were convinced developing countries were stuck in a cycle of poverty. Because the country was poor, most of its citizens were just getting by, meaning there was a low national savings rate, which led to low investment, which created underfinanced and uncompetitive industries, which led to low growth, which continued the poverty circle. Aid was intended to meet the financing gap—the difference between the national savings rate and the amount of investment needed to grow the economy. The method was simple: a ‘required’ investment rate could be calculated to meet the target growth rate. Remarkably, William Easterly confirms this formula is still taught in training courses at the World Bank and IMF and is pervasive throughout development literature.¹⁶

The obvious fallacy of this analysis is its assumption that output is directly proportional to capital investment. The Harrod-Domar equation was formulated for full employment models in industrialized countries, and even then only in the short-term. For development studies, it is misguided because it ignores the other inputs for growth and assumes that any investment in machines this year would have a one-to-one mapping on next year’s growth. This simplification overemphasized physical capital accumulation, leading to a multitude of projects throughout Sub-Saharan Africa that did not contribute to growth, were not needed, and contributed to the massive debt in the region.

The Harrod-Domar analysis is indicative of the first generation of developmental economists’ emphasis on state intervention in the markets. As Gerald M. Meier summarizes, the role of the state in development was “to promote capital accumulation, utilize reserves of surplus labor, undertake policies of deliberate

¹⁴ It is interesting to note that by 1957, Domar himself had disavowed the theory. He said he never had any intention to derive “an empirically meaningful rate of growth,” and that his theory made no sense for long-run growth. William Easterly, *The Elusive Quest For Growth* (The MIT Press: Cambridge, Massachusetts, 2001), p.28.

¹⁵ Easterly, p.28.

industrialization, and coordinate the allocation of resources through programming and planning.”¹⁷ The belief at the time was developing countries did not have reliable market systems. Because of the recent perceived market failures of the Great Depression, economists were open to more state involvement in the economy, an attitude that would change with the second generation of development experts.

It was the rise of market fundamentalism and neoclassical economics that shifted developmental economics theory in the 1980s. Development advisors warned states to ‘get the prices right’ and not interfere in the economy.

Rather than grand theories of development, the emphasis of the period was on microstudies. The rapidly increasing amount of data from the developing countries led to various studies showing the economic costs of tariffs or the distorting effects of subsidies. Further discrediting Harrod-Domar, high rates of savings were shown to be neither necessary nor sufficient for development. Efficient markets were praised, and interference with them was seen as growth inhibiting.

During this time, economists revisited the work of Nobel laureate Robert Solow. In 1957, he published an article with the surprising conclusion that investment cannot be a source of growth in the long run because of diminishing returns. Using the neoclassical production function, Solow argued growth is a function of capital accumulation, labor input and technical progress. Because continued investment in either capital or labor would lead to diminishing returns as the ratio of capital to labor becomes skewed, and there is a naturally limited pool of labor, a sustained increase in GNP can only be achieved by productivity increases, or the amount of production per worker. Technological change, he argued, is the only true long-term determinant of growth.

Economists concluded that governments could do very little to impact the long-term growth rate. While programs to increase national savings rates or provide more ‘effective’ labor could help on the margin, for the most part development was seen as outside the control of domestic governments. A government’s responsibility was to remove barriers to growth and then allow market forces to take care of the rest.

¹⁶ Easterly, p.36.

¹⁷ Gerald M. Meier and Joseph E. Stiglitz, eds., *Frontiers of Development Economics: The Future in Perspective* (Oxford University Press: New York, 2001), p.15.

Eventually, this view consolidated in the neoliberal Washington Consensus, a strict formula of liberalization, marketization and privatization.

However, there was light at the end of the tunnel for the governments of developing countries. A corollary of the neoclassical growth theory was the convergence theory. This posited that because of the technology gap between industrialized and developing countries, the developing nations could make substantial productivity gains by borrowing existing technology. Labor productivity in the developing world would increase faster than in the industrialized world, thus giving larger growth rates to the countries farther behind. Over time, this diffusion of technology, along with additional capital in the form of foreign investment, would enable less developed countries to converge with the industrialized nations through rapid growth.

One problem with the neoclassical growth model is that all economic evidence disputes the convergence theory. As William Easterly points out, a simple thought exercise can show the fallacy. Today, the poor countries are just barely above a subsistence level of not starving to death. Therefore, they must not have had significantly lower income two hundred years ago, as much less income and they would not have survived. The rich countries, for which we do have data, have had substantial growth of income per person over the last two centuries. Of course, more rigorous data analysis has also been done, and confirms that divergence has increased rapidly since 1820.

A second critique of the neoclassical model is that it fails to identify the sources of technological advance. As Robert Gilpin writes, “Although the theory teaches that technological progress bears the primary responsibility for increases in per capita income over the long run, the theory does not explain the determinants of technological advance.”¹⁸

In response to the deficiencies of the neoclassical model, ‘new growth theory’ was developed in the late 1980s and 1990s. Based on the work of Paul Romer, among others, new growth theory incorporates technological progress and advances in knowledge as endogenous factors within the growth model. Romer’s thesis was that technological advance was the result of conscious investment in technology—firms

¹⁸ Gilpin, p.111.

and entrepreneurs had to make the decision that increasing research and development spending would increase profitability.

Other market failures were also added to the developmental theory. Economists became increasingly aware of imperfect and costly information, incomplete markets and high transaction costs in developing nations' economies. Risk and asymmetrical information were emphasized more than in the past. As new insight into the weakness of markets in developing countries progressed, more attention was given to the role of government.

In combination with the rise in international political economy, new growth theory has once again reintroduced the role of the developmental state. Governments are seen as active contributors to growth, in that they must provide a stable macroeconomic environment. New growth theory acknowledges that markets operate within national political environments. Instead of 'get the prices right,' economists encourage governments to 'get institutions right,' and increase support for research and development as well as growth of human capital through education and training.

New growth theory utilizes new data provided by the rapid development in East Asia to support greater government intervention in markets. While neoclassical economists disagree, new growth theorists attribute the 'Asian Tigers' phenomena to the active role those governments played in encouraging private investment in strategic industries as well as in slowing and, more importantly, carefully sequencing the liberalization and privatization processes. Rather than unfettered markets, these economies displayed the proper complementarity between government and market.

Thus, development theory has shifted its focus from governments to markets and then back to governments in its search for the sources of growth. However, in practice not all economists have accepted the market interventions of new growth theory. Many economists, particularly those in powerful positions, remain steadfast in their support of neoliberal orthodoxy, as represented by the continued preeminence of the Washington Consensus. The central debate of developmental economics today is between the neoliberalism of the Washington Consensus and the developmental state of new growth theory; what is the best balance between market and government involvement in an emerging economy? I take up this challenge in the next section.

DEVELOPMENT IN PRACTICE: A CRITIQUE OF THE WASHINGTON CONSENSUS

In the last few years, this theoretical debate surrounding state-involvement has become particularly contentious.¹⁹ Work from scholars in the developing countries (Bond, Deng, Ndulu) and from ‘post-consensus’ scholars in US (Stiglitz, Sachs) has attacked the World Bank and the IMF for both their policies and their prominent role in international development. Though without the same quantity of work, or high profile attention, the Bretton Woods institutions have defended their practices in both official statements and informal interviews.

The debate has centered on the IFIs’ (International Finance Institutions, used here as an abbreviation for the World Bank and IMF collectively) strict adherence to neoclassical market fundamentalism, or the so-called “Washington Consensus.” As a term, the Washington Consensus was first used in 1989 by economist John Williams to describe the policies advocated by the US Treasury, World Bank and IMF. Though he was writing specifically about the development strategy for Latin America, the Consensus won quick appeal as a universal growth strategy. Pared down from Williams’ original list of ten items, the Consensus came to represent three main goals: “macroeconomic discipline, a market economy and openness to the world (at least in respect of trade and FDI).”²⁰

This section examines each of the three tenets of the neoliberalist Washington Consensus as the World Bank and the IMF have utilized it. For each point, there is a discussion of both the advantages and disadvantages, as advocated by the participants themselves, and then an assessment based on the evidence available. Following the review of the policies specifically, attention is given to the broader concerns about the current role of the IFIs in structuring the development programs throughout the world.

¹⁹ See in particular Stiglitz (2002), Bond (2002) and Rogoff (2003).

²⁰ John Williams, “Did the Washington Consensus Fail?” Speech for the Institute of International Economics, November 6, 2002. Online. <http://www.iie.com/papers/williamson1102.htm>. February 6, 2003.

Macroeconomic Discipline

Of the three pillars of the Washington consensus, this one may be the most secure. Along with nearly all developmental economists (including many supporters of new growth theory), the World Bank and the IMF advise macroeconomic discipline - the closing of fiscal deficits and tightening of monetary policy to control inflation. It is widely accepted that sustained economic growth can only occur in a low inflation environment, which is the outcome of macroeconomic discipline. The recent contention, however, lies on the margin - the extent and timing of austerity measures implemented by the IFIs.

Critics, such as Nobel Prize winning economist and former Chief Economist at the World Bank Joseph Stiglitz, have voiced concerns about the IMF's strict austerity measures. Stiglitz has become a champion of the developing countries by arguing that the financial 'straightjacket' that the IMF imposes on developing countries does more harm than good. Basic economics, Stiglitz contends, teaches students that the correct response to a recession is increased spending in order to stimulate the economy. IMF policies do exactly the opposite. Facing a country that is in the midst of slow or negative growth, the IMF imposes strict conditions on spending to balance the budget. Stiglitz agrees fiscal discipline is sound advice in general, but contends the timing of IMF austerity policies have lengthened and deepened developing country recessions.²¹

On similar grounds, Stiglitz objects to IMF monetary recommendations. The Fund typically insists upon high interest rates in order to curb inflation. Stiglitz, however, believes that the resulting high cost of capital would "make job creation impossible even in the best circumstances."²² He believes maintaining a low cost of capital, and thereby encouraging entrepreneurship and job creation, is a better solution because it would stimulate growth initially.

In addition to the economic problems generated by the macroeconomic discipline conditions of the IFIs, it must be noted that they impose severe political costs on the recipient country. They force governments that, by the fact that they are working on loans from the IFIs, are in a dire situation already to severely cut

²¹ Joseph Stiglitz, "Finance for Development," Lecture at University of Cape Town. March 25, 2002.

²² Joseph Stiglitz, "Globalization and Its Discontents," (Allen Lane: London, 2002), p.17.

spending. Inevitably, the fragile governments must cut back on social spending, weakening already porous social safety nets as well as eroding political support for the government and potentially destabilizing the country. Especially with the increased amount of private investment in the last ten years, new growth theorists insist that any measures contributing to political destabilization should be revisited, as maintaining investor confidence has become an integral part of national development strategies.

In response to the critics, the IMF defends its policies by appealing both to conventional economic theory and modern reality. Tough choices must be made, they insist, because fiscal discipline is indisputably linked to economic growth.²³ Countries that continue to spend beyond their means will inevitably end up with enormous debts and have to pay significant amounts just to service the debts, detracting from their ability to invest in the future or provide for social spending (as has happened throughout much of Africa today.)

With regard to interest rates, the IMF contends high rates of return are necessary to generate adequate levels of investment. It is an economic reality that for investment to occur interest rates must adequately reflect the level of risk in the economy. When the IMF has been called, there is a significant probability of default. Without a higher return to offset this increased risk, investors will not return.

In specific response to the idea that countries can spend their way out of problems by temporarily increasing deficits in order to stimulate demand and restart the economy, Ken Rogoff, economic counselor and director of research at the IMF, insists the proposal is nonsense. He draws a parallel to supply-side economics, a now widely discredited theory, which believed it could generate the same amount of tax revenue by cutting the tax rate and waiting for the increase in growth to offset the loss. According to Rogoff, increasing government spending for countries that are already running significant deficits in a no-growth, or low-growth environment has been proven not to work many times in economic history, most recently during the deficit booming 1980s in America.

While the IMF concedes its macroeconomic discipline policies have a mixed record, it believes the countries would be in much worse shape without their

²³ Ken Rogoff, "The IMF Strikes Back," *Foreign Policy*, January/February 2003, p.39-46.

intervention. Because the IMF is by definition a lender of last resort, countries must be in significant financial difficulty when the loans are made. Michael Camdessus, former Managing Director of the IMF, maintains it is important not to mistake correlation with causation. It should not be surprising that there is a positive relationship between countries in economic turmoil and the number of loans from the IMF, but this does not imply the loans caused, or exacerbated, the problems.²⁴ While the detractors point to various cases as failures, he insists many of the same cases were successes, when looked upon relative to where the country would have been without IMF intervention.

Nevertheless, a review of IMF structural adjustment programs reveals a mixed record, at best.²⁵ However, neither new growth theory nor prominent IMF critics provide a viable alternative in the case of fiscal discipline. Countries must maintain fiscal discipline in order to promote growth. There are no short cuts, and typically when the IMF arrives countries are running massive deficits. In fact, in some cases the political cover brought by the IMF enables countries to curb out of control spending more effectively.

Tight monetary policy, however, may not be the same bitter, though required, medicine. The policy admittedly hampers local entrepreneurs and small business growth by making capital more expensive in exchange for increasing investment. Recent studies, however, have shown there is no relationship between growth and investment in the previous term. Moreover, 90% of the time that sustained growth did occur (over 7% for four years), it was not preceded by substantial investment.²⁶ If the attraction of increased investment is less appealing than previously thought, then the costs of raising interest rates (stifling domestic growth) appear to be unwarranted.

The most damning criticism of the IMF's macroeconomic discipline programs is the simplistic manner in which they are proscribed. While the goals are indeed desirable in the long run, the IMF does not take into account the social and political implications of its rigid austerity programs. In the short term at least, poverty increases as government spending declines. Many governments cannot survive the

²⁴ Michel Camdessus, "An Interview with Michel Camdessus, *Foreign Policy*, September/October, 2000, p.32-45.

²⁵ For example, William Easterly cites a study by Przeworski and Vreeland that found a negative correlation between IMF programs and future growth. (With the appropriate caveat by IMF chair Michael Camdessus that correlation does not imply causation.) Easterly, p.115.

political consequences. While investment may not have a correlation with growth, supporters of new growth theory have shown political continuity does. By decreasing political stability, as well as having devastating effects on the poor, the rigid macroeconomic programs of the IMF are too embedded in neoclassical economics (markets without social and political context), failing to account for the wider political economy of developing countries.

Privatization (market economy)

The second pillar of the Washington Consensus is establishing a market economy. Advocates insist on privatizing state-run industries and deepening financial markets. Again, the economic argument for private enterprises is sound. They are indisputably more efficient than state run operations because they utilize price signals and better align incentives between management and operations. However, many developmental economists argue the structural adjustment programs of the Bretton Woods institutions rush privatizations, imposing them on countries that are not equipped to regulate a market based system.

For privatization to work successfully, adequate preparations must be made to prepare the markets, institutions, regulatory frameworks and social safety nets. New growth theorists contend that the IMF does not appreciate these difficulties. Markets do not immediately appear. While the transition is made, there are considerable social costs both to the consumers and to the laid off workers.²⁷ Especially in developing countries where there is imperfect information, limited financial resources, and virtually no social safety net for displaced workers, adequate preparations must be made before privatizations can occur. Without regulatory and legal frameworks in place, monopolies capable of extracting rents from consumers and making everyone worse off can emerge. In addition, rapid privatization has been rife with corruption in Africa (as well as in the countries of the former Soviet Union), as politicians can sell state industries for below market value and keep a slice for themselves or their supporters.

²⁶ Easterly, p.39.

²⁷ Stiglitz, p.56.

In the face of widespread criticism for the handling of privatizations throughout the developing world, and in Africa in particular, the IMF maintains that privatization allows for the most efficient distribution of resources. Even if the initial sale involves corruption, in the long term the market will regulate and end up more efficient in the end.

As Keynes is often quoted, 'in the long term, we are all dead.' The issue is the avoidable tremendous short-term costs that rushed privatizations create. Economically, privatizations make sense. In reality, however, the political economy of developing countries necessitates a slow road to privatization. New growth theory has provided valuable evidence about the dynamics of information and markets in developing countries. The data support privatization only if it is part of a wider, more comprehensive program. Ensuring the rule of law, property rights, regulatory measures and some program for job creation for displaced workers is required. Timing and sequencing are vital.²⁸ Unfortunately, the IMF has failed to recognize the lessons from previous failed privatizations and continues to push rapid, flawed privatization programs.

Liberalization (openness to the world)

Liberalization, or as John Williams originally phrased it, openness to the world, must be separated into two distinct categories. Trade liberalization, the lowering of tariffs and nontariff distortions in the global trade of goods and services, and capital market liberalization, the opening of domestic financial markets to foreign investment. The two types of liberalization each bring their own benefits and problems, and therefore must be evaluated independently.

Despite strong political interests to the contrary, economics has proven international trade can increase growth throughout the world. The benefits of increased trade, however, are not evenly distributed within countries or between countries. Nevertheless, the IMF has promoted trade liberalization as a way of

²⁸ Stiglitz, p.57-8.

generating growth in developing countries, a view that is widely agreed as the correct decision.²⁹

Few credible economists dispute the relationship between the opening of markets and economic growth. Once again, it is the timing and implementation of the IMF programs that causes concern among certain development economists. Even when trade is in the long run best interest of the country overall, measures must be taken in order to alleviate the displacement of workers in domestic industries exposed to international competition and to maintain employment. In developing countries, replacing lost jobs can be especially difficult. As Joseph Stiglitz writes, “[I]t takes capital and entrepreneurship to create new firms and jobs, and in developing countries there is often a shortage of the latter, due to education, and the former, due to lack of bank financing.”³⁰

IMF critics advocate a more gradual process of trade liberalization, buffered by government initiatives to ease the transition. New growth theorists highlight the East Asian countries as examples of the extensive government involvement in the liberalization process. The ‘Asian tigers’ dropped barriers, but cautiously, and over time to allow domestic industries to prepare and a sufficient number of jobs to be created through increased exports. China is still in the process, over twenty years after it moved to ‘marketize’ the economy.³¹

A second concern about trade liberalization is the increasingly disparate terms of trade. While the IMF forces developing countries to lower tariffs and nontariff barriers to trade, many industrialized countries remain protected in areas critical for the developing countries. Free trade will only promote growth in the developing countries if their exports are able to enter the more lucrative industrial nations’ markets. Many believe the IMF has acted solely on behalf of the North, ignoring the increasing disparate terms of trade between the developing and developed world.

Despite the increasing public furor over ‘fair trade’ in goods and services, the debate does not reach the same level among developmental economists as the debate over capital controls. Possibly because the former is more of a political issue and the

²⁹ Shahid Yusuf and Joseph E. Stiglitz, “Development Issues: Settled and Open,” in *Frontiers of Development Economics: The Future in Perspective*, p.229.

³⁰ Stiglitz, p.59.

³¹ Stiglitz, p.60.

latter an unresolved economic issue, the debate over capital market liberalization is a dominant issue in developmental economics literature.

At the most extreme levels, IMF detractors accuse the Fund of maliciously promoting capital market liberalization as a ploy to benefit private financiers in the industrialized world. In more benign circles, critics accuse the IMF of naively opening markets too fast, before adequate stabilization measures are put into place.

Opening a country's capital markets allows for the free flow of investment into and out of the currency. It attracts 'hot' money, short-term loans and contracts - which are usually little more than bets on exchange rate fluctuations - that can move into and out of a country overnight. While proponents argue it deepens the financial resources available to a developing country, detractors claim the effects can be destabilizing. Many believe the recently opened capital markets prolonged and deepened the East Asian financial crisis in 1997.³²

The most vocal critic of capital market liberalizations has been Joseph Stiglitz, who makes two critical points. First, it does not help to attract foreign investment (as the IMF contends) because investment is scared away by the destabilizing effects. He cites China as an example of a country that attracts significant investment (the most in the developing world) while refusing to open its capital markets.³³

Secondly, despite the IMF claims, opening capital markets doesn't provide more liquidity for the economy. To offset the increased risks associated with the volatile loans, the IMF insists countries must maintain adequate reserves equal to their short-term foreign denominated loans. Because they are required to keep reserves in a stable currency, most use American dollars. This means they must hold reserves in US treasuries, earning interest at 4%, in order to accept an equal amount of foreign capital (a majority of which comes from the US), for which they have to pay interest at 18%. Therefore, developing countries are simply subsidizing the US trade deficit by giving loans at a lower rate than they are receiving. Each year, the developing

³² Stiglitz, p.99.

³³ In 2002, China actually received more foreign direct investment (\$53 billion) than the US, though that was due more to the tremendous drop in US FDI (down from \$301 billion in 2000), a drop in part caused by the uncertainty of US markets, supporting Stiglitz's argument. "Is the wakening giant a monster?", *The Economist*, February 15th, 2003, p.67.

countries lose roughly 14% of their capital without generating any additional capital for investment.³⁴

The IMF concedes it may have been a little overzealous in its promotion of capital markets. It now supports open capital markets as a goal for developing countries in the long run because domestic investment cannot generate enough capital to spur growth (the legacy of Harrod-Domar continues), but believes sound institutions must first be put into place. To counter the argument about open capital markets worsening the Asian crisis, Ken Rogoff points to both Australia and New Zealand as countries with open capital markets that didn't experience the full Asian slump, in part because they had "highly developed domestic financial markets that were extremely well-regulated."³⁵ The danger, Rogoff admits, is for the countries in the middle, those that open their markets without the established institutions to control and regulate speculative attacks—economies that combine weak financial markets and poor regulation.

That, it seems, is exactly the point of Stiglitz and others who oppose the opening of capital markets in developing countries. It is bad economics because developing economies are –virtually by definition– small and inexperienced in financial regulation. Without adequate support systems, the risks are too great, as evidenced by the IMF recommendation that they keep foreign reserves equal to the amount of short-term loans they are taking in. For capital market liberalization to make sense, financial markets must have solid footing and credible regulators. The complexity of the issue may explain why Europe, industrialized since the nineteenth century, only opened its capital markets in the in the 1970s.

The Current Role of the World Bank and IMF

In addition to the objections raised about the specific policies of the IFIs, there has been considerable debate about their preeminent role in international development. Though bilateral aid is the dominant source of financial transfers to developing countries, the Bretton Woods institutions retain tremendous influence. Economists object to their expanded role in policy advising, in addition to demanding

³⁴ Stiglitz, lecture at UCT. Also, *Globalization and its Discontents*, p.66.

³⁵ Ken Rogoff, "The IMF Strikes Back," *Foreign Policy*, January/February 2003, p.39-46.

more transparency from within the two Washington organizations. In reviewing the current landscape of developmental economics, a review of these debates is necessary before the discussion of alternatives.

When they were chartered at the Bretton Woods conference in 1944, the International Bank for Reconstruction and Development (World Bank) and the IMF were designed with very different goals. The World Bank was intended to help with the war reconstruction and assist in raising the level of private investment to developing countries. The IMF was designed to be a source of emergency finance, a 'lender of last resort' for developed economies with short-term liquidity problems. World economists, particularly John Maynard Keynes, worried about the interconnections of the global economy and the 'spillover' effects a country in trouble might cause. By creating an emergency source of liquidity that could be utilized by a member of the world community in a domestic downturn, Keynes sought to address a market failure by enabling struggling countries to maintain full employment and prevent the spread of another global depression.

Despite the sound logic of its' inception, some economists argue the IMF seems to have lost its intellectual coherence as development theory has shifted within the last two decades. A product of the first generation of development economists, the IMF was designed by Keynes to address a market failure - the inability of countries to raise liquidity in cyclical downturns. Now, however, the IMF reflects the market fundamentalism of the second generation, insisting on limited state involvement because of the unfailing ability of the market.³⁶ If the market is always correct, why is there ever a need for IMF intervention?

More worryingly, however, the IFIs have expanded well beyond their initial mandate. Beginning in the 1980s, the World Bank and the IMF began to extend their role through structural adjustment programs (SAPs). In order to induce recipients to change policies, the Bank shifted from making loan conditions on specific projects to making conditions on macroeconomic indicators, such as balanced budgets, low inflation and annual growth targets.

During this time, the Fund dramatically increased the number of loans and the length of maturity on its loans. As a result of their new 'adjustment with growth'

³⁶ Stiglitz, p.196.

policies, the IFIs became extensively involved in shaping the domestic economic policy of recipient countries. The IMF was no longer just a crisis resource, but a permanent fixture in the landscape of economic development. Throughout the 1980s and 1990s, as the scope and power of the World Bank and IMF grew, many loans were made, and yet, remarkably little growth was achieved.³⁷

In fact, rather than producing any growth, the loans had the effect of dramatically increasing the national debts of many African countries. As the IMF and World Bank continued to make an increasing amount of new loans, the burden of debts began to erode any positive effects of new loans. As evidence of the increasingly problematic relationship between the African countries and the IFIs, a 1995 African Development Report showed “there was a net outflow of resources from adjusting economies to the creditors, especially to the IMF and World Bank, during the second half of the 1980s and early 1990s.” Between 1990 and 1992 the capital outflows totaled \$4.58 billion for Africa as a whole.³⁸

As the SAPs became widespread throughout Africa, many scholars grew increasingly critical both of the growing power of the IFIs and their uniformity of response to the economic problems of developing countries. For example, Lual Deng of the African Development Bank has written about the conflicting role of IMF and World Bank as lenders and policy advisors. He argues they ignored basic economic advice by requiring the African governments to pay loans back (to them) at the early stages of SAP development, rather than allowing the capital to remain in the developing economy.³⁹

Opponents have argued the SAPs were unsuccessful because in many cases they were designed and implemented without regard to the domestic political economies. The World Bank and the IMF ignored stakeholders, did not acknowledge the critical political and legal reforms that were required, and resisted popular participation and empowerment of the citizenry.⁴⁰

With regard to the uniformity of recommendations, economists have pointed to the World Bank and IMF’s strict allegiance to the Washington Consensus policies

³⁷ Easterly, p.102.

³⁸ Lual A. Deng, *Rethinking African Development: Toward a Framework for Social Integration and Ecological Harmony* (Africa World Press: New Jersey, 1998), p.50.

³⁹ Deng, p.51.

⁴⁰ Deng, p.58.

without regard to the local situations. Opening markets before they were ready, pushing privatization when a corrupt government could exploit the situation and failing to recognize the socio-political costs of the austerity programs are all complaints raised against the Consensus, as discussed above. While there may be nothing wrong with the policies in the abstract, economists have complained about “the way in which they have been formulated and applied without any due attention to the prevailing objective conditions in most of the African countries.”⁴¹

Perhaps the most widespread criticism of the World Bank and the IMF is their lack of transparency. They remain shrouded in secrecy, a few thousand economists hidden away on H Street in Washington DC, unassailable and insulated from both the actual circumstances in the developing countries and due democratic process. The policies are formulated in private meetings, the officials are not elected by any populace, and the decisions escape public scrutiny. Compounding the troublesome image of a cabal of corporate interests secretly colluding, the country representatives are hardly unaligned with certain domestic interests. At the World Bank, the country representatives are trade ministers, advocating the views of industry. At the IMF, they are finance ministers and central bank governors, representative of the finance industry. Especially because the policies that emanate from World Bank and IMF meetings affect so many, an increasing number of development economists insist upon greater transparency within the Bretton Woods institutions.

Why Change is Required

The current system of international development in Africa is untenable because of the continued underdevelopment of much of the continent in the face of fifty years of Washington-led programs. The strict adherence of the World Bank and the IMF to a neoliberal, market-oriented development paradigm, as well as their persistent efforts to expand their mandate and become permanent custodians of most developing countries’ economic policies has impeded growth in Sub-Saharan Africa. The Washington Consensus is somewhat a misnomer, because it implies universal agreement for these policies. Increasingly, the objections to the policies have spread

⁴¹ Deng, p.46.

from the developing countries to the halls of the institutions themselves, as was the case with Joseph Stiglitz and William Easterly.

Moreover, the situation is untenable because the Washington Consensus applies a discredited economic model for development. The programs of macroeconomic discipline, privatization, and liberalization are all honest goals, but are being pushed on developing countries in an unsustainable manner. Because it fails to acknowledge the wider social and political institutions that must be in place, new growth theory predicts the Consensus is doomed to fail. Data from the last twenty years confirms this view. The Washington Consensus is too simplified. The World Bank and IMF continually neglect the more comprehensive social and political development that must precede economic development, while assuming the wide-ranging institutions required will spring up as if by royal decree. Former Managing Director of the World Bank Jessica Einhorn captures it best, though too diplomatically, by writing, “the bank is in danger of overdetermining development to the point where it is a tautology, not a reasonable prescription. To argue that developing countries need market-friendly policies, stable macroeconomic environments, strong investments in human capital, and independent judiciary, open and transparent capital markets, and equity-based corporate structures with attention to modern shareholder values is to say that you will be developed when you are developed.”⁴²

Alternatives are possible. This analysis of the Washington Consensus and the IFIs has proceeded as a template for a comparative study. Of course, not everything is incorrect about the existing development structures. Many of the goals and recommendations are sensible and achievable. However, a new program with its origins in the developing world, its emphasis on the wider social implications of domestic economic policy and its structure defined by the recent additions to development theory from political economy, could substantively improve the future for the millions of people struggling below the poverty line in Sub-Saharan Africa.

⁴² The World Bank’s Mission Creep, Jessica Einhorn, *Foreign Affairs*, Vol 80, Num 5, 2001, p.31.

THE PATH FROM HERE: AN ALTERNATIVE GROWTH TEMPLATE

It is time for a new paradigm. After nearly fifty years of throwing money at the developing world (albeit money not necessarily intended for development) and having policies emanate from Washington DC, change is overdue. To begin, we must take a broad perspective: What are the critical factors affecting development, what can be learned from the past successes (and failures) and, most importantly, what is achievable in the current global political economy?

A first step is to look at the evidence. What has contributed to or inhibited growth over the last forty years? From the extensive economic research that is continually providing data and analysis we have been given some insights. I will divide my analysis into factors relating to domestic political and economic realities in the developing countries and to the policies and practices of international aid organizations.

Internal Factors Affecting Growth

Until the recent progress made by new growth theory, most developmental economists did not treat local governments as endogenous variables in their models. Too often governments were treated as philosopher-kings, always acting in the best interest of the state. Of course, this overly simplistic modeling caused a tremendous amount of difficulty. As one researcher put it, it is only a recent recognition in development literature that “regimes – particularly in Africa – were not only *not* truly concerned with ‘development’ but willing, indeed eager, to sacrifice national growth for regime survival.”⁴³

The introduction of political economy into development literature has aided researchers in identifying factors that inhibit growth. Politicians in developing countries, like politicians worldwide, prefer power, survival in office, influence and electoral (if there are elections) support. They only become willing reformers or

⁴³ Thompson and Thompson, p.89.

supporters of policies that contribute to economic growth when it is in their rational interest; namely, when they believe they will lose their job if they do not change.⁴⁴

Without that force, governments will continue to act against the best interests of the nation state as a whole. The key insight of political economists, to explain what had previously been perceived as the irrational behavior of many governments, is that the ‘tragedy of the commons’ occurs.⁴⁵ William Easterly, of the World Bank, shows how governments will rationally pursue reckless, growth-killing policies because their access to government resources is limited. Rather than build an economy for the future, the government will steal what it can today on the assumption that someone else will be in power at a later date.⁴⁶

While all governments face a similar incentive to cheat, it is particularly because many developing countries have weak, illegitimate governments that destructive policies are pursued. Knowing there is no widespread consensus or mandate to rule, the government must maximize its return during the limited opportunity it has in power. As a result, one of the leading indicators of when a government will pursue destructive policies is the degree of social polarization.

In his study of developmental policy, Easterly calls social polarization “the fundamental difference between redistributionist and developmentalist governments. Societies divided into factions fight over division of the spoils; societies unified by a common culture and a strong middle class create a consensus for growth—growth that includes the poor.”⁴⁷ Without cohesion, countries have a tendency to flounder between populist governments redistributing income, without growth, and elites who suppress mass education and democracy. Easterly traces the roots of social polarization to great inequality or ethnic conflict. Evidence supports the thesis, as researchers have found a correlation between high income or land inequality and low growth.⁴⁸

⁴⁴ Merilee S. Grindle, “In Quest of the Political: The Political Economy of Development Policymaking,” in *Frontiers of Development Economics*, p.350.

⁴⁵ Previously, economists believed the interests of the government would be aligned with the state even if the government was entirely corrupt and self-interested. Because you can steal more from a rich country than a poor country, development economists believed even bad governments would support growth.

⁴⁶ Easterly, p.259.

⁴⁷ Easterly, p.256.

⁴⁸ This thesis has also been used by economic historians to explain why the United States, which had enough land to grow a strong middle class and low inequality, grew much more quickly than South

Following Easterly's argument, countries that have a high number of ethnic groups will have greater social polarization and therefore exhibit slower growth. Intuitively, there are many reasons why this may be the case. For example, in a country with many languages, there will not be as strong an incentive for universal education, as there are no knowledge leaks from one group to another. To test his theory, Easterly uses the probability that two individuals from the same country will speak different languages as a proxy for ethnic diversity. Interestingly, this measure is highest in Sub-Saharan Africa, which has had notoriously slow growth over the last forty years, and lowest in Korea and Japan, two of the fastest growing economies in the world over the same period. The full results are given in the chart below.

Table 1: Ethnic Diversity and its consequences for policies, 1960-1989

	Average, quarter of sample least ethnically diverse (%)	Average, quarter of sample most ethnically diverse (%)
Ethnic diversity (probability of two people speaking different languages)	5	80
Per capita growth rate per annum	3.0	0.9
Policies		
Black market premium	10	30
Financial depth (broad money ^a /GDP)	47	22

Source: William Easterly, *Elusive Quest for Growth*, p.273.

^a Broad money is the total assets of the banking system.

The chart shows that the least ethnically diverse countries grew roughly three times as fast as the most ethnically diverse countries. Other economic indicators, such as the black market premium on the currency and the financial depth of the banking systems, were substantially better in the least ethnically diverse areas.

The implications of Easterly's research are significant. Rather than focus strictly on market reforms and reigning in government spending, his findings show development policy must also work to shift allegiances from ethnic factions to a

America, where a limited amount of land and multitude of sugar plantations and mines kept inequality high. See Easterly, p.266.

national identity. Efforts to impose strict macroeconomic discipline can undermine weak governments and perpetuate instability and ethnic divisions.

External Factors Affecting Growth

In addition to the recent insights in endogenous factors contributing to the economic growth of developing countries, new analysis has identified how international efforts can be refined.

Although long at the center of basic economic analysis, developmental economics seems to have lost sight of one fundamental tool: incentives. Governments, people, international agencies, politicians, and common citizens all respond to incentives. If you believe your government is corrupt and will steal any income, you do not have much of an incentive to work. If you believe there will be no opportunities for employment with a degree, you do not have much of an incentive to educate yourself. If you believe the level of international aid is unrelated to your policies, you do not have much of an incentive to improve.

Between 1980 and 1994 Zambia received 12 loans from the World Bank and IMF. During this time, at the height of the neoliberal structural adjustment programs, maintaining low-inflation was a key goal of economic reform. Yet, between 1985 and 1994, Zambia had inflation over 40% every year except 2.⁴⁹ Because the IFIs made no effort to withdraw aid according to the policies of Zambia, there was little incentive to lower inflation. Consequently, inflation remained.

Throughout the developing world countries with more poor get more aid. The World Bank and IMF lower aid amounts as countries begin to alleviate poverty and conditions improve. One study showed that a doubling of per capita income leads to a 33 percent reduction in aid.⁵⁰ Rather than having no incentive to improve policies, this actually provides a disincentive to reduce poverty – encouraging poor governance. The World Bank confirms this relationship in their own internal study,

⁴⁹ Easterly, p.105.

⁵⁰ The World Bank, *Assessing Aid: What Works, What Doesn't, and Why*. (Oxford University Press: New York, 1998), p.41.

Assessing Aid: What Works, What Doesn't and Why, which shows there is little correlation between good governance and total amount of aid.⁵¹

International donors must get the incentives right. They must increase their selectivity, rewarding countries that pursue good policies with more aid. The same World Bank study showed that in a good policy environment, a one percent of GDP increase in aid increases growth by .5 percentage point, a rate of return of approximately 40%, assuming a depreciation of roughly 10 percent a year.⁵² However, in a weak policy environment similar amounts of aid were much less effective. For aid to work, it must reward good policies.

Recent studies have also helped international donors recognize the best time to increase aid. In a World Bank study from 1998, a sample of 60 countries was used to determine whether an increase or a decrease in aid was more likely to induce better policies. "They identify 87 episodes in which there is a surge in aid (a large change relative to what the country had been receiving.) In only six of the 87 episodes was the surge followed by significant reform. In 92 cases in which there was a large decline in aid, 16 were followed by reform. Thus, reform is more likely to follow a decline in aid than an increase in aid."⁵³

With regard to the type of aid needed to spur growth and development, there has been important recent scholarship. It is widely agreed that capital investment, in the style of the Harrod-Domar equation, does not lead to growth. Similarly, in the words of William Easterly, the "growth response to the dramatic educational explosion of the last four decades has been distinctly disappointing."⁵⁴ In fact, there is "no positive association between growth in human capital and growth of output per worker."⁵⁵ If it is not physical capital growth, or human capital growth, what, then, can spur growth in developing countries?

Differences in productivity growth (output per worker) explain over 90% of the differences across countries in per capita growth from 1960 to 1992.⁵⁶ If international donors focused on improving productivity per worker, development

⁵¹ *Assessing Aid*, p.43.

⁵² *Assessing Aid*, p.36.

⁵³ *Assessing Aid*, p.49.

⁵⁴ Easterly, p.72.

⁵⁵ Easterly, p.74.

⁵⁶ Easterly, p.176.

efforts would be much more efficient. One of the best ways to do this is by increasing investment in technology and subsidizing local research and development.

In the past, international aid has not been as effective as it could have been because it was allocated according to Cold War politics or it was based upon simplistic economic models of development. Today, with the end of the Cold War and more systematic analysis of aid programs, international aid is poised to become much more effective. By imposing selectivity, giving more aid to the countries that implement sound development strategies, and focusing on the political economy of recipient countries, aid can significantly contribute to the international development process.

Building Better Institutions

While keeping in mind the above discussion about domestic and international factors contributing to past success and failure, this section tries to set forth a new plan for development; a plan centered on empowering countries themselves.

First, countries must ‘get the institutions right.’ By institutions, I do not mean merely the identifiable government or private-sector agencies and organizations, but the entire social contract of the society. I will take Douglas North’s broader definition of institutions from *Institutions, Institutional Change, and Economic Performance*; he writes that institutions are “humanly devised constraints that shape human interaction.”⁵⁷ A society’s institutions encompass all formal and informal rules and norms of behavior as well as the brick and mortar buildings of governance.

Following colonialism, neither the formal nor the informal institutions that define a unified nation had evolved. Many African states were left with a transitional economy in which more than 75% of population was subsistence farming. Societies were divided between ethnic groups, with different social norms and means of authority in different regions. Moreover, the abrupt independence of many countries left a “political system which almost inevitably empowered the charismatic, not

⁵⁷ Douglas North, *Institutions, Institutional Change, and Economic Performance*, (Cambridge University Press: New York, 1990), p.3. As quoted in Lancaster, p.18.

necessarily qualified, leaders who devised economic models with as much potential as zeppelins loaded to the brim with concrete.”⁵⁸

With hindsight, we can see development strategies may have been more successful if they had focused on solidifying the states, helping to bring together the many multi-ethnic states. Economic development requires a strong (not necessarily big) government. States must be able to regulate the economy, enforce the rule of law and property rights, and maintain peace and security. Today, many states must build their capacity before growth will return. In “State Capacity and Effective Governance,” Deborah Brautigam argues that African states must build capacities in four areas: regulatory (legal), to ensure predictability; technical, to provide greater stability; taxation, to raise revenues; and administrative, for effective government service with minimal red tape.⁵⁹ Currently, she notes, African governments are filled with low morale, low skill levels and low accountability.

Building strong national institutions is the only way African governments will be able to break out of the poverty cycle. In the formal sector, this means eliminating some of the incentives for corruption, such as a high black market premium for domestic currency. Other less tangible institutions will be strengthened as a meritocratic civil service, a vibrant free press and an active civil society are established. In addition, recent work by the World Bank has highlighted how international aid can promote stronger institutions.⁶⁰

African Contributions

Another road to growth, and one that complements the strengthening of institutions, is greater ownership of the development process by the African countries. Currently, development is widely designed by anonymous economists on H Street in Washington DC. As a result, World Bank and IMF officials must pressure governments to adopt reform plans in addition to convincing them they are the correct solutions to the country’s problems.

⁵⁸ Thompson and Thompson, p.7.

⁵⁹ Deborah Brautigam, “State Capacity and Effective Governance,” in *Agenda for Africa’s Economic Renewal*.

⁶⁰ *Assessing Aid*, p.83.

African Development Bank economist Lual Deng believes the World Bank and IMF policies have ignored “traditional African thought and culture.” Without input from African intellectuals, Deng believes the designs were doomed from the outset. As he has written, “I would argue the adjustment programs in the 1980s – like the modernization paradigm – were inconsistent with African development thought. The cornerstones of this development thought are family-hood, sharing, and consensus-building, which the SAPs tend to undermine through their emphasis on individualism and self-seeking motives.”⁶¹

Part of the problem is the lack of voices coming from Africa. E. Gyimah Boadi and Nicolas van de Walle insist that a broader and more sophisticated debate about economic policy is needed by African elites.⁶² Deng goes further by referring to an ‘Intellectual poverty’ that “has allowed inappropriate development policies and strategies that are inconsistent with African thought and culture to be applied with impunity”...“The ‘intellectual poverty’ in Africa manifests itself mainly in the absence of a serious African scholarship that can systematically guide development policy formulation and ensure its consistency with African thought and culture.”⁶³

An intellectual contribution to development theory by Africans themselves is crucial for two reasons. First, without input, the resulting policies do not adequately correspond with African attitudes, social institutions, and value systems. As a result, they are often ill suited for the African context and predestined for failure. Secondly, without African contribution, there is the psychological effect of lack of ownership. Governments are less inclined to battle with different constituencies and fight for the reform efforts, further diminishing the chances of success.

If African states are going to be able to breakout of their cycle of poverty, they must first buy into the development process. By creating policies that reflect African traditions such as community inclusiveness and ‘consensual’ government, African intellectuals can make development policies both more effective and empowering.

⁶¹ Deng, p.44.

⁶² E. Gyimah Boadi and Nicolas van de Walle, “The Politics of Economic Renewal in Africa” in *Agenda for Africa’s Economic Renewal*, p.45.

Growth through Agriculture

The last aspect of the alternative approach to growth is a renewed commitment to agricultural development. Since the first wave of developmental economics in the 1950s and early 1960s, industrialization has been the emphasis. However, with agriculture dominating both the domestic economy and the exports of most Sub-Saharan African states, it makes sense to focus on strengthening agriculture as a foundation for further economic growth.

The primary role of agriculture in Africa's economy is indisputable. Agriculture employs 60% of the labor force, accounts for 40% of the exports and for between 20 and 33% of the continent's GDP.⁶⁴ Yet, it is still a largely undeveloped sector. Africa uses only 25% of its arable land, compared with Asia, which uses 64.6%. In the last twenty years agricultural yields, the amount of food raised per hectare, have grown substantially throughout the world but have stagnated in Africa.

There can be two forces for economic growth in the agricultural sector of Africa's economy. First, improving the production side. Africa's farmers need to be empowered to plant what they want. Promoting land reform has the potential to raise production by aligning the incentives of the farmer with the output. Currently, sharecroppers have to share half their crop, essentially a 50% tax on production. Without the tax, more investment in agriculture would be made. A properly administered peaceful land reform plan, in which workers get access to land, credit and instruction of new techniques, could significantly boost output. A precedent has been set by Korea and Taiwan, where successful land reform policies preceded their remarkable developments.⁶⁵

African states can help. In addition to moving ahead with sensible land reform policies, states can encourage agricultural production by providing access to yield-enhancing inputs such as technology and credit - a particularly vital need for many small, independent farmers because of the substantial upfront costs of farming. Promoting agricultural research, providing micro-finance and improving domestic

⁶³ Deng, p.100-1.

⁶⁴ Deng, p.111.

⁶⁵ Stiglitz, p.81.

infrastructure to reduce the cost of getting crops to markets, especially valuable overseas markets, would all contribute to agricultural growth.⁶⁶

The second major force for economic growth in the agricultural sector comes from increasing demand. Specifically, ending the costly protectionist policies of many developed countries in order to open more markets for African products.

It is a well-known 'dark secret' that while the developed world has been pushing for increased liberalization in the developing countries (as a fundamental tenet of the Washington Consensus no less), they have been systematically protecting their markets from the exports of developing countries. Recent studies estimate that over \$700 billion worth of trade barriers still confront exports from developing economies to the OECD, and agreed measures to liberalize key sectors, like agriculture, have been sluggishly enforced in the developed world.⁶⁷

The current scenario is especially duplicitous because the protections left in the developed countries fall disproportionately in areas where developing countries are able to provide exports, with the prime example being the agricultural supports. Both the European Common Agricultural Policy (CAP) and the US farm and sugar subsidies are examples of the industrialized nations' selectively enforced free trade principles. As a result, the agricultural exports of the developing countries face tariffs that exceed those on OECD exports (of all products) by factors of 10 or more.⁶⁸

While recent multilateral trade negotiations, such as the Uruguay Round, have brought attention to the issue, current political realities have prevented any improvements. In fact, the situation may be deteriorating, as one World Bank calculation showed that the Uruguay Round actually reduced incomes in Sub-Saharan Africa by more than two percent as a result of further liberalization in areas favorable to the industrialized world.⁶⁹

The irony is these supports hurt the developed countries as well. In addition to inhibiting growth in the developing countries, to whom they then make sizable bilateral aid transfers, the protection is paid for by consumers. Estimates of the static

⁶⁶ Christopher L. Delgado, "Agricultural Transformation: The Key to Broad-Based Growth and Poverty Alleviation in Africa," in *Agenda for Africa's Economic Renewal*.

⁶⁷ Adil Najam and Nick Robbins, "Seizing the future: the South, sustainable development and international trade." *International Affairs*, Vol. 77, Num 1, Jan 2001, p.49-68.

⁶⁸ "Market Access for Developing Country Exports—Selected Issues," The World Bank and IMF, September 26, 2002. Online, <http://www.worldbank.com>, February 2, 2003.

⁶⁹ Stiglitz, p.61.

gain alone that would result from eliminating the barriers to merchandise trade range from US\$250 billion to US\$620, of which between one-third and one-half would accrue to developing countries and the rest would remain in the developed nations.⁷⁰

In order for full agricultural growth to occur in Africa, these political hurdles must be overcome. Unifying voices, through the Non-Aligned Movement, has helped some, and the agricultural supports are on the agenda for the current Doha Round of the multilateral agreements, but more political pressure must be put on the industrial countries to live up to their promises of 'free and fair trade.'

CONCLUSION

This chapter has made the argument that the current landscape of economic development for Sub-Saharan Africa is systematically ill conceived and inefficient. Beginning from a state-centric realist position, I have made the case that the current structures are best understood as the products of the North and do not have the best interests of the South in mind. While those in power, at the World Bank and the IMF as well as the leaders of many industrialized nations, voice concern and sympathy, their actions run counter to their words. The growth in the power of the Bretton Woods institutions over the past twenty years has further hampered growth programs.

These powers continue to strictly adhere to the Washington Consensus, despite widely published revisions to the premises of these policies. As the debate on the merits of the Washington Consensus shows, the policies should not be entirely discarded. Following the demise of the Soviet Union, it seems convincing to say any program for development must incorporate the basic tenets of sound macroeconomic policy, international openness, and a market based system. However, the Consensus as implemented by the IFIs hurts countries, rather than aids them.

Pushing rapid privatization, opening capital markets and trade barriers before local markets and regulators are ready and forcing social spending cuts in times of need are all areas where the policies seem to benefit the industrialized countries rather than reflect the latest development theory.

Using the concepts of new growth theory, and the expanding goals of development, I have suggested alternative areas for emphasis. Yes, market discipline

⁷⁰ "Market Access for Developing Country Exports—Selected Issues," Online, February, 2, 2003.

and reform must come, but if it is moderated by these reforms it will be more successful.

First, development projects must be more inclusive. They cannot merely focus on ending deficits and selling state assets. Programs must first build capacity within the countries for reform. Following the work of others, I have emphasized investing in national unity, strengthening institutions and solidifying government power.

Second, the countries themselves must be brought into the fold. Development programs shaped by African voices will be accord with regional thought and culture. Following this advice, the call given by many African economists for growth through agriculture should be heeded.

Third, the international community must make better use of incentives. Aid programs will only contribute to growth if aid encourages good governance by rewarding it with more aid. Selectivity is needed. Within states, also, they must fund projects most likely to lead to growth – recent data shows this means investing in productivity growth, not capital.

Enacting these reforms in the quickest manner possible is the best hope for Africa. As argued above, globalization is not nearly complete, meaning that reforming the system remains possible. The end of the Cold War has brought about a new opportunity for development in Africa. The continent no longer needs to be a battleground for Cold War politics.

However, if any of these recommendations are to evolve political leadership, long a weakness for the continent, will be key. As William Easterly's research has shown, governments can impede progress just as easily as they can advance it. Building consensus, gaining legitimacy, establishing public trust in government and maintaining a viable social contract are essential. Responsible governments are needed, both to provide stability and regulate markets domestically and to represent national interests internationally. There is little hope of success in the critical task of opening industrialized nations' markets without legitimate leaders effectively making the case to their counterparts in the North.

As the case study below illustrates, this type of leadership can exist on the African continent. South Africa has emerged from decades of being a political and economic pariah to become the leading hope for Africa. The next chapter builds on

the continental perspective provided in this chapter by focusing specifically on South Africa's development experience. The differences and similarities are essential to understanding the true causes of sustainable development.

University of Cape Town

CHAPTER TWO: DEVELOPMENT IN SOUTH AFRICA, A CASE STUDY

To quote one South African academic: in South Africa, more than any other country, development is a political issue.⁷¹ While South Africa has been intimately involved in the worldwide debate on issues in development, the unique political, economic and social circumstances have required unique solutions.

Nearly fifty years of authoritarian, minority rule has left deep divisions in the political and economic landscape. Apartheid created a two-tiered economic system. The white minority enjoyed a first-world infrastructure as well as high levels of employment, income and other indicators of human development, while the vast majority of the population languished in poverty typical of the developing world with poor literacy, electrification, sanitation, income and employment statistics. Until 1994, no real attempt was made to provide an inclusive national development program.

With its exceptional history, the choice of South Africa as a case study for Sub-Saharan development requires some justification. The relative wealth, political stability and overall size of the economy give it tremendous advantages over the typical Southern African country. However, as the analysis below will show, I believe South Africa faces many of the same issues.

Moreover, it is precisely because of its unique position that South Africa's development is worthy of study. The lessons learned from South Africa's experience are vitally important to understanding the political economy of development in the region. The remarkable opportunity for a politically legitimate government to internally create its own development policies without significant outstanding debt or a legacy of failed programs helps to identify the crucial variables missing from other countries in the

⁷¹ Ben Turok, *Beyond the Miracle: Development and Economy in South Africa* (Fair Share: Cape Town, 1999), p.2.

region. Africa is desperately in need of a success story, both for its self-image and for its international reputation. South Africa's development is widely viewed as a crucial opportunity to promote stability and growth in the region. By identifying and isolating the differences between South Africa's experience and that of the rest of the continent, insight can be gained on how to best break the cycle of poverty and economic underdevelopment throughout the continent.

DEVELOPMENT THEORY: THE SOUTH AFRICAN CONTEXT

South African development theory includes the ongoing debate over the Washington Consensus and the relevant arguments of the previous chapter, but it is also shaped by the high levels of inequality within the society. What Ben Turok alludes to in his assertion that politics is central to development in South Africa, is the delicate balance between the politically empowered black majority and the economically empowered white minority.

South African development policy is shaped by the extreme conditions brought about by the legacy of apartheid. Nation building and inclusiveness are essential early targets. Maintaining the support of both the wealthy minority stakeholders and the previously disadvantaged populace has been critical. While there have been stumbles along the way, the continued peace and relative prosperity (compared both to other developing countries in the past decade and the world economy in the last three years) is both remarkable and a testament to the country's economic leadership.

Nation Building

As if directly following the recent literature on the adverse effects of social polarization (see the discussion of William Easterly's work in Chapter One), the ANC immediately began the process of unifying the deeply divided populace when it took power in 1994. In his inauguration address to the city of Cape Town, President Mandela's first words were, "Today we are entering a new era for our country and its

people. Today we celebrate not the victory of a party, but a victory for all the people of South Africa.”⁷² From that point forward, reconciliation and national unity became a primary objective of the government’s development strategy.

As part of this plan, new national symbols, such as the flag and anthem, were created to generate national pride from all communities. The Truth and Reconciliation Commission provided a peaceful, therapeutic way to address the injustices of apartheid, as well as to leave the painful legacy in the past. In addition, the government capitalized on Mandela’s ability to command respect from the whole country, white and black, to maintain optimism. An example of the state-led movement to develop a national pride encompassing all South Africans was the coordinated response to the 1995 Rugby World Cup.

Today, the effort continues. Officials from all levels of government still frequently refer to the ‘new’ South Africa, as if to emphasize the change in opportunities. The government’s recent ‘Proudly South African’ campaign is evidence of the ongoing effort to maintain optimism and unity in the future – as well as to promote domestic production.

The Economic Platform: Washington Consensus, or Not?

A second critical issue in South African development theory, as in any country, is the proposed source of growth. Because of the unique political economy of the country, with the large percentage of capital in the hands of select few and the political power centered away from those with the economic control, South Africa is a particularly interesting case study.

In 1994, political control of the country shifted from the economically conservative, white minority to the mass-based, communist-supported ANC. South Africa reentered the global economy as sanctions fell away from important world markets for the first time in nearly twenty years. The tremendous changes left many wondering which course South Africa would take. The business community feared reckless

⁷² Mandela, Nelson, “Address to the People of Cape Town on the Occasion of his Inauguration as State President,” May 9, 1994. Online, <http://www.polity.org.za>

spending, protectionist trade policies and political instability. The ANC's alliance partners, the South African Communist Party (SACP) and the Congress of South African Trade Unions (COSATU), expected significant social spending and labor protection.

In reality, South Africa's macroeconomic policy has remained remarkable disciplined, more so even than it was in the last fifteen years of the Nationalist Party regime. Without facing the harsh loan conditions of the World Bank and IMF directly, South Africa has adopted the Washington Consensus almost exactly as enumerated by the Bretton Woods institutions. Understanding how and why the ANC turned to market discipline upon gaining control of the country; or, as one commentator put it, how it "went from Marx to Milton Friedman with a moment's notice" is crucial to understanding the political economy of the country, and the extent that the ANC's policies are repeatable throughout Southern Africa.⁷³

The legacy of the ANC, though it is sometimes disputed, is that of a mass-based movement, with "a strong commitment to the disadvantaged, especially the poorest of these."⁷⁴ Even though many contend the ANC was always less a populous and a more middle-class, professional movement, it certainly derives its main support nationally from the disadvantaged. Moreover, with its key alliance partners the SACP and COSATU, there was every indication that the ANC would prefer more progressive, protectionist policies upon gaining political control of the country.

One possible hindrance, however, was the nature of the control the ANC actually gained. The negotiated settlement with the Nationalist Party, while preserving general peace and a political transition, left much of the economic control of the country in white hands. To many observers, "white South Africans got away with murder."⁷⁵ In their effort to secure a smooth and quick transfer of political power, ANC negotiators allowed for extensive concessions to the white community. Protecting property rights, guaranteeing continued employment for politically allocated public sector jobs, and other measures essentially locked in the radically skewed economy that the apartheid policies

⁷³ Peter Vale, *International Affairs*, Vol 78, Num 3, July 2002. The quote appears in a review of Patrick Bond's book.

⁷⁴ Turok, *Miracle*, p.26.

⁷⁵ Mamphela Ramphele, "Citizenship Challenges for South Africa," in *Daedalus: Why South Africa Matters* (Journal of the American Academy of Arts and Sciences, Vol. 130, Number 1, Winter 2001), p.11.

had created. By leaving the massive concentration of economic control in white hands, the ANC limited its possible economic policy alternatives.

However, it is too simple to insist that the ANC is merely catering to the economically powerful white minority with its' economic policies. In fact, the inverse may be true. While the distorted economic reality in South Africa may have forced the ANC's hand, it is presumptive – and incorrect, I believe – to insist the current leadership does not honestly believe its' market based, neo-liberal approach is in the best interest of all South Africans.

Many theorists have argued it is global realities, not domestic ones, that have pushed the ANC to the right. This view, common among the many left-leaning political scholars in South Africa, answers the riddle of the ANC shift by saying “the leadership came to the conclusion that the neo-liberal economic orthodoxy is the only show in town, or, more conventionally, that there is no alternative.”⁷⁶ The neoliberal Growth, Employment and Redistribution (GEAR) is interpreted in the context of international globalization, an economic reality beyond the power of any country, much less South Africa, to stop.⁷⁷

Less polemically, some scholars have shown the shift can be explained by the rare power enjoyed by the ANC following the first election. Following the first nation-wide elections in 1994, Mandela could be more secure in his authority than most African leaders. The situation met the two primary conditions for economic reform: a competent and coherent economic team, and political leadership that were willing and able to insulate them from political pressures.⁷⁸ Because of its overwhelming public support, the ANC was able to take a long-term perspective and endure the short-term political costs associated with macroeconomic discipline. In this view, it is the unique circumstances of the extended political ‘honeymoon,’ itself a result of the long liberation struggle, enjoyed by the ANC that enabled them to push the economic reforms that have been externally imposed on the rest of the continent by the World Bank and IMF.

⁷⁶ Neville Alexander, *An Ordinary Country: Issues in the Transition from Apartheid to Democracy in South Africa* (University of Natal Press, Pietermaritzburg, 2002), p.150.

⁷⁷ Estian Calitz, “The South African Economy in an Integrated Global Economy: Features, Prospects and Implications,” in Hennie Kotze, ed., *A Future South Africa? Prospects for 1999 and Beyond* (Center for International and Comparative Politics: Johannesburg, 1997), p.52.

Of course, this implies the ANC supported the neoliberal agenda itself and used the opportunity to push a policy it believed in. Without theorizing on the internal ANC debates, which itself would demand an entire thesis, one approach to this problem is the rational actor model. In order to gain political power, the ANC aligned itself with the largest source of domestic support, the trade unions. However, as a more middle-class movement the ANC intellectual cadre, especially the exile corps in Lusaka, never fully subscribed to the left's agenda. Once in power and because its domestic support was virtually assured by the issues surrounding apartheid, the ANC was able to move to the right and impose a development program that conforms to the international consensus of a sound development program – thereby raising its' standing in the international community.

Indeed, the significant economic reforms, begun with the Reconstruction and Development Program (RDP) in 1994 and furthered along with GEAR in 1996, coincide almost directly with the broad guidelines of the Washington Consensus. Strict budgetary discipline, evidenced by annual deficit targets, has been adhered to with every ANC budget – much to the disappointment of many who expected broader social spending. By maintaining its tough fiscal austerity program, the government has tried to lower the persistent inflation that has hampered the South African economy for the past twenty years.

Although external events such as the Asian financial crisis and a weak Rand (in one case due to false rumors of President Mandela being ill) have held inflation rates high, tight monetary policy has complemented the fiscal policy by trying to slow the constant price increases. As part of its development strategy, the government created an independent central bank based on the inflation targeting German Bundesbank model. As a result, South Africa's macroeconomic discipline has been held up as a model for others in the region.

In addition to the austerity measures, the government has pursued the Consensus in privatization, trade and strategy. Since 1994, South Africa has been pursuing a slow but steady privatization program of core state assets. The recent Telkom share offer was

⁷⁸ Stephan Gelb, "South Africa, Africa and The New Partnership For Africa's Development," (The Edge Institute, September 2002), p.1.

the latest in a series of privatizations and partial privatizations of state assets, which totaled R14.8 billion in assets between April 1994 and February 2000.⁷⁹ Moreover, the government has lowered tariffs faster than their WTO agreements required, while GEAR targeted Small, Micro, and Medium Enterprises (SMMEs) as the source of development. In sum, South Africa's macroeconomic discipline, increased foreign trade, attempts to attract foreign investment, SMMEs investment and programs designed to increase human capital, present a development strategy distinctly based on a Washington Consensus template.

However, though the broad themes of South Africa's development strategy have unquestionably been aligned with the Washington Consensus, there are essential differences that reflect both domestic concerns and the recent developments in new growth theory.

The South African government was acutely aware of the problems associated with rushing macroeconomic discipline, privatization, and liberalization. Since 1994, these three tenets of the Washington Consensus have been long-term goals, but they have been pursued at a deliberate pace. The privatization program described above was deliberately paced to avoid rent-seeking monopolies and massive corruption. The deficits inherited from the Nationalist government were slowly reduced to a sustainable rate over the course of five years. The pace and sequencing of the ANC Consensus-based reforms make it substantially different from the typical structural adjustment program implemented in Southern Africa.

Secondly, the government has provided significant incentives for investment in both education and technology. President Mbeki, virtually echoing the recent writings by Paul Romer and others in new growth theory, recently justified these measures by saying, "Technology by itself will not necessarily eradicate poverty, nor will it end underdevelopment. Yet, the availability of technology and its dissemination amongst many sectors of society, is a critically necessary condition for economic and social development."⁸⁰

⁷⁹ Leslie Boyd, Michael Spicer, and Gavin Keeton, "Economic Scenarios for South Africa," *Foreign Affairs*, Vol 79, Number 4, 2000, p.82.

⁸⁰ Bond, p.123.

Thirdly, the South African government has adopted a more comprehensive approach to development, incorporating Sen's development as freedom approach. The Black Economic Empowerment programs represent the government's commitment to expand the opportunities for previously disadvantaged groups. While opponents claim the measures have moved too slowly, there remains a constant push by the government, manifested in the various BEE programs and incentives (one example is the recent Mining Charter imposed on the mining corporations), to provide a more equitable future.

A fourth key difference, which separates the South African development program from that of its neighbors, is the absence of the IFIs. Unlike any other country in Sub-Saharan Africa, the fiscal and monetary discipline has been entirely self-imposed.⁸¹ From the very inception of ANC development strategy, as articulated below in the 1994 RDP statement, maintaining ownership of domestic economic policies has been a central tenant:

“Relationships with international financial institutions such as the World Bank and International Monetary Fund must be conducted in such a way as to protect the integrity of domestic policy formulation and promote the interests of the South African population and the economy. Above all, we must pursue policies that enhance national self-sufficiency and enable us to reduce dependence on international financial institutions.”⁸²

The fifth fundamental difference of South Africa's development strategy, and the subject of a much longer discussion in the next section, is the active engagement of the international community, both in the North and the South, to structure better terms of trade, and complement the domestic economic development plan.

The Political Platform: NEPAD and Regionalism

In addition to the neo-liberal domestic economic platform, a core principle of South Africa's development program has been to redefine its international relationships.

⁸¹ To the extent that the current global economic environment allows this to happen. To clarify, what I mean by “self-imposed” is that the reforms were not as a result of conditional loans, structural adjustment policies, or debt relief packages from the IFIs.

The transition to a majority ruled government has allowed South Africa to reengage both with the Southern Africa region and continent, and the global community. The government has seized this opportunity in an attempt to change the entire African development landscape.

As discussed in Chapter One, many development theorists have been calling for increased African leadership and contributions to development. Too often, they contend, strategies for development emanate from Washington without a real appreciation for local conditions, local institution and local values. As a result, these ‘solutions’ are destined to fail.

In response to the call for continental leadership, South Africa has taken a lead in reshaping the development landscape. President Mbeki, along with Nigerian President Olusegun Obasanjo, Algerian President Abdelaziz Bouteflika and Senegalese President Abdoulaye Wade, presented The New Partnership for Africa’s Development (NEPAD) to the OAU Summit in Lusaka in July 2001.⁸³

As its introduction states, NEPAD is a pledge by African leaders to “extricate...the continent from the malaise of underdevelopment and exclusion in the globalising world.”⁸⁴ The objective, again to use their own language, “is to consolidate democracy and sound economic management on the continent.”⁸⁵ It sets both long-term objectives, as in the case of eradication of poverty on the continent, and near term goals such as the enrollment of all children of school age in primary schools by 2015.

The basic thesis of NEPAD is that in return for aid, investment, debt relief and increased trade opportunities, African states will provide democracy, good governance and peace. At its core, NEPAD seeks to redefine the relationship between Africa and the donor community. By shifting from a mode of dependency to active participation, NEPAD attempts to improve the efficacy of international aid efforts. With African

⁸² African National Congress, *Reconstruction and Development Programme*, 1994. As quoted in Bond, p.vi.

⁸³ NEPAD was titled the New Africa Initiative (NAI) between July and October 2001. It was adopted by the OAU as a combination of President Wade’s OMEGA plan and the Millennium Africa Recovery Programme (MAP) of Mbeki, Obasanjo and Bouteflika.

⁸⁴ NEPAD, p.1. As quoted in Richard Gibb, Tim Hughes, Greg Mills and Tapani Vaahtoranta, eds., *Charting a New Course: Globalization, African Recovery and the New Africa Initiative* (South African Institute of International Affairs: Pretoria, 2002)

⁸⁵ Gibb, p213.

ownership, the leaders insist, comes the additional resolve to see projects through and the improved dignity of the African people.

NEPAD hinges on instilling this greater pride in the continent. By removing the image of an outstretched hand in search of a donation and fostering the belief in genuine partnership with the North, NEPAD is designed to end the Afro-pessimism so pervasive on the continent.

Moreover, the plan confirms the African leaders' view that democracy is fundamental to growth. President Mbeki calls the "complete liberation of peoples of the continent" one of the "important preconditions for the renewal of Africa."⁸⁶ As such, membership in NEPAD requires countries to sign a Democracy and Political Governance Initiative that demands good governance conforming to international standards. Among the conditions are parliamentary democracy, fixed terms of office for national leaders, and an independent judiciary. To ensure these commitments are more than empty gestures, an independent peer review will take place every three years.

It is this peer review mechanism that leaders point to as the substantive departure from previous attempts at development. For the first time, African governments will be imposing their own conditions for sound practices on their neighbors. Regional collective action is intended to strengthen the ability of governments on the continent to maintain democratic reforms in the face of domestic groups that have an interest in maintaining the poor government practices (As discussed in Chapter One). This external pressure, a creation of NEPAD, is designed to solve the recurring problem of weak states regressing into authoritarian regimes.

The response from the international community has been very positive. As President Mbeki confirmed, "The element that has enabled the marketing of NEPAD is that it is an African initiative. We are making our own commitments about democracy, about peace, about corruption and about homegrown efforts to put our own resources into development."⁸⁷

However, while the language appears strong, it is still uncertain how the peer review mechanism will work in reality. Many observers point to the recent trouble in

⁸⁶ Mbeki, speech to Joint session of Parliament, Oct 31, 2001. As quoted in Gibb, p.138.

⁸⁷ Peter Hawthorne, "The Selling of Mbeki's New Deal," *Time*, June 10, 2002.

Zimbabwe, and President Mbeki and Olusegun's reluctance to take a strong stand against the Mugabe regime as evidence of a lack of resolve to maintain the NEPAD goals. The missed opportunity, together with the continual problems of 'good governance' on the continent, has led to increased concern over this aspect of NEPAD.

Which leads to the question, why would South Africa want to tie itself to such a troubled continent? Why, in the aftermath of the transition, when South Africa had the remarkable opportunity to define its place in the world, did it chose to form closer links with the consistently underachieving Sub-Saharan Africa?

One answer, of course, is the natural affiliation South Africa feels towards its own continent. Especially following the long freedom struggle that was heavily supported by neighboring countries there certainly was a sense of allegiance to the region. Moreover, as a relatively prosperous and powerful country, there was a moral obligation to contribute to regional development as a whole.

However, there is an alternative to this idealist interpretation. A realist approach to explain of South Africa's commitment to NEPAD is to look at the current international political realities. In this view, South Africa needed improved conditions on the continent, in addition to the credibility provided by being seen as the African leader, to advance its own national interest.

Many scholars have documented the regional spillovers affecting South Africa. The poor economic performance and governance in Sub-Saharan Africa has created negative perceptions for investors, both foreign and domestic.⁸⁸ As a result, "investment rating services list Africa as the riskiest region in the world. Indeed there is some evidence that Africa [that is Sub-Saharan Africa] suffers from being perceived by investors as a 'bad neighborhood'. ...Africa as a whole is rated significantly more risky than is warranted by these [economic] fundamentals."⁸⁹ Despite being a markedly different economy than its regional counterparts, South Africa is affected by this international perception, as the evidence in the next section will show.

Because South Africa – whether justly or not – is perceived as a member of the African community, with its associated increased risks, it has an incentive to end the

⁸⁸ Gelb, *NEPAD*, p.22.

negative perception. If, through NEPAD, South Africa can encourage good governance and sound macroeconomic policies from enough of its neighbors, then investors will begin to make distinctions between countries with sound policies and those without; eliminating the negative externality for South Africa.

From this view, NEPAD can be seen as an investment just like any other. By improving their neighborhood, South Africa hopes it can increase both domestic and international investment, as well as avoid other significant potential risks such as cross-border movements of people (political refugees), disease and conflict.⁹⁰ Rather than benevolent leadership by South Africa, the program is seen as a calculated advancement of national interest.

A second pragmatic reason for South Africa to be the most active supporter of NEPAD is the role it creates for South Africa in the global community. NEPAD gives President Mbeki a stronger platform when he demands changes in the basic structures of international organizations.

South Africa, like all developing countries, would benefit significantly by 'fair' terms of trade. As shown in Chapter One, the current international system of trade favors the industrialized world at the expense of the developing countries. As a central goal, NEPAD, in Thabo Mbeki's words, "seeks to achieve a new, better and equitable deal for Africa within the global community."⁹¹

NEPAD strengthens the bargaining position of the African countries in two ways. First, it unifies their voices. NEPAD sets clear demands for a more equitable trading system, as well as prioritizing the issues to clarify the position of the African countries. Second, it provides increased credibility. By acknowledging ownership of African development, and making firm commitments for good governance and accountability, NEPAD is an attempt to redefine the relationship between the African countries and the industrialized world.

President Mbeki, as a leader of this movement, is given opportunities to directly address the leaders of the North that would be unavailable if he was merely representative

⁸⁹ Paul Collier and Jan Willem Gunning, "Why has Africa grown slowly?" *Journal of Economic Perspectives*, 13 (3), 1999, p.20. As quoted in Gelb, *NEPAD*, p.22.

⁹⁰ Gibbs, p.35.

of own country. At the 2002 G-8 Summit in Kananaskis, Canada, for example, Mbeki presented the case for a more equitable global economy to the leaders of the world's seven largest economies and Russia. Since NEPAD was announced in 2001, Mbeki's profile has increased throughout the industrialized world, as can be seen from his frequent speaking engagements to audiences ranging from ASEAN to the UN General Assembly. NEPAD has solidified a new role for South Africa in the global community - as a bridge between the North and the South.

While its NEPAD leadership is the latest example of South Africa's attempt to bridge the divide, its political leadership has been positioning itself in this role since the end of apartheid. Beyond the African continent, South Africa has become an active leader of the developing world in many venues. Since 1994, South Africa has been chair of 113 member Nonaligned Movement, the 53 member Commonwealth, and the UN Conference on Trade and Development, in addition to having Trevor Manuel on the Board of Governors of IMF and Mamphele Ramphela as a Managing Director of the World Bank.

This bridging role is another key piece of South Africa's development strategy. By becoming a leader in the developing world, South Africa has been able to shape the agenda - as evidenced by its ability to push developing countries to participate in the Doha Round of the WTO, to achieve reforms from within the system rather than shunning trade liberalization overall.⁹² Additionally, the South African leadership hopes that its' higher profile on the global stage will attract much needed foreign investment.

In addition to its global implications, South Africa's advancement of NEPAD has direct benefits for its regional strategy. Through SADC, South Africa is also attempting to solidify its role as a connection between the South and the North. Because South Africa stands in the awkward position of having a relatively skilled labor force and relatively high wages (in addition to very powerful trade unions) its development strategy cannot rely on growth through cheap labor-intensive manufacturing, the textbook growth strategy used by the 'Asian tigers.' As such, a fundamental focus of the development

⁹¹ Thabo Mbeki, "Address by the President of South Africa and Chairperson of the African Union," 8th ASEAN Summit, Phnom Penh, November 5, 2002. Online, <http://www.polity.org.za>.

⁹² Peter Vale and Sipho Maseko "South Africa and the African Renaissance," *International Affairs*, Vol. 74, Num 2, April 1998.

strategy is increased regional integration – combining the cheap labor of the other countries within SADC with the skills and manufacturing of South Africa. South Africa can become an intermediary between the lower income agriculture based countries in Southern Africa and the industrialized nations. Essentially, an integrated SADC could act as a microcosm of the global economy, with South Africa the regional hegemon.

For this strategy to work, however, SADC needs more comprehensive regional integration. The current debate within SADC lies in ‘open’ or ‘closed’ regionalism.⁹³ Closed regionalism refers to regionalism where the regional market is the end goal. Growth is expected because trade barriers are eliminated and producers have access to an enlarged regional market. Reducing tariffs, non-tariff barriers and other impediments to trade is the primary focus of ‘closed’ regionalism. So far, this characterizes SADC’s regional integration approach. In contrast, open regionalism attempts to use the regional economy as a launching point towards the larger global economy. Open regionalism seeks trade and cooperation linkages beyond the immediate geographic region. The focus is on coordinating production, pooling resources and more effectively capitalizing on intra-regional comparative advantages. This is the type of regionalism that can provide the greatest benefits for South Africa.⁹⁴

Thus, NEPAD’s emphasis on responsible government and macroeconomic policies can also be seen as South Africa’s advancement of regionalism as a defense against globalization. For, as Stephen Gelb has written, “without the improvements in governance which NEPAD seeks, it is hard to imagine the increased harmonization of standards and the ease of cross-border movement which integrated production tied to global networks would require in the region.”⁹⁵

South Africa’s enhanced presence in regional, continental and global international affairs should be viewed as a concerted effort by the ANC to improve domestic economic conditions. For analysis, this section has divided South Africa’s development theory into two sections, the domestic economic policies and the international maneuvering. Yet, both are, and should be seen, as integral and complementary aspects of a coordinated strategy for development.

⁹³ Gibbs, p.37.

⁹⁴ Gibbs, p.37.

As has been shown, South Africa's development strategy reflects current international development theory while also incorporating a distinctly South African approach. The next section sets out to assess this strategy by looking at the evidence. Is South Africa's development program working? What are the key indicators we must look at? Using the government's own theory for development, I intend to provide a critical analysis of the progress made in the past eight years, as well as the prospects for the future.

ECONOMIC REALITY: THE SOUTH AFRICAN EXPERIENCE

Any attempt to evaluate a national development strategy must be clear of the desired outcome of development itself. While this certainly demands a more thorough discussion (an attempt of which is given in Chapter One) it may be helpful quote what the policy makers themselves are striving for. In his last budget speech, Finance Minister Trevor Manuel opened his remarks with the following quotation from Amartya Sen:

Freedom is both the primary objective, and the principal means of development...What a person has the actual capability to achieve, is influenced by economic opportunities, political liberties, social facilities, and the enabling conditions of good health, basic education, and the encouragement and cultivation of initiatives. These opportunities are, to a great extent, mutually complementary, and tend to reinforce one another.⁹⁶

While much of the further discussion will center on how the 'economic opportunities' of the South African people have changed in the last nine years, it is important to acknowledge the broader goals of development. Manuel's quotation above roughly corresponds to the theoretical approach to development taken by the ANC, as discussed in the last section. By actively addressing the massive inequality left by apartheid, establishing macroeconomic stability, and providing continental and regional

⁹⁵ Gibbs, p.37.

⁹⁶ Amartya Sen, *Development as Freedom*. As quoted by Trevor Manuel, "Budget Speech By Minister of Finance TA Manuel," February 26, 2003. Online, <http://www.polity.org.za>.

leadership, the government has indeed focused on trying to enhance every South African's 'actual capacity to achieve.'

The government's efforts to address the deep divisions within society have met limited success. The campaigns designed to solidify a common national identity have struggled to alter the ingrained self-image of many South Africans. As Mamphela Ramphele has recently written, 'dual citizenship,' between one's own group (white, black, Zulu, Xhosa, Afrikaner, etc.) and the nation continues to create tension.⁹⁷ Even within the government, Ramphele cautions that 'radical rhetoric masks the pursuit of narrow self-interest' by ANC officials.⁹⁸ In addition to the racial legacies from apartheid, the strong sub-national identities fostered by unions and political parties (ANC, IFP, COSATU) further impede the development of national identity. For example, Ramphele notes how the ANC's continued policy of self-disciplining members who hold public office undermines the development of accountability in public service and inhibits the growth of a strong civic culture.⁹⁹

While healing the wounds of apartheid will take generations, nation building has proceeded faster than many believed it could in 1994. Despite the eleven official languages, English (for better or worse) is rapidly becoming a unifying force between disparate communities. Increasingly, the 'dual citizenship' Ramphele correctly identifies is fading as national allegiances arise. Based on William Easterly's recent research, it appears all efforts by the government to accelerate this process should be encouraged.

In contrast to the 'softer' goal of national unity, the more tangible goals of greater equality of opportunity remain more elusive. In 1993, the top decile of households earned half of the total income, while the bottom four deciles (which account for 52 percent of population because poor households have more people) took home less than 10 percent of total income.¹⁰⁰ However, the government has kept its commitment to

⁹⁷ Ramphele, p.7.

⁹⁸ Ramphele, p.7.

⁹⁹ Ramphele, p.10.

¹⁰⁰ Nicoli Nattrass and Jeremy Seekings, "Race and Economic Inequality in SA," *Daedalus: Why South Africa Matters*, p.48.

support this segment of the population. Spending on the same bottom four deciles of the population increased by fifty percent between 1993 and 1997.¹⁰¹

Unfortunately, as Nicoli Nattrass and Jeremy Seekings have recently shown, the government's program of economic transfers may be too simplistic to achieve the desired development goals. While President Mbeki and the ANC are targeting economic inequality through black economic empowerment and other race based initiatives, a majority of the income inequality in South Africa today is within the black population rather than between different race groups.¹⁰²

In 1975, only two percent of the top decile of households, ranked on income, were black, while ninety-five percent were white. By 1996, the top decile was twenty-two percent black and sixty-five percent white.¹⁰³ Certainly, there is not income equality between race groups, but the achievements of many within the black population have created greater disparity within the race than within the population as a whole.

By analyzing the decile breakdown of household income, Nattrass and Seekings contend the key determinant of inequality in South Africa is employment, not race. For example, most machine operators and similar semiskilled workers are in deciles six to nine, meaning they generally earn more than fifty percent of the population.¹⁰⁴ Most unskilled laborers are spread between the fourth and eighth deciles. Thus, a household containing one unskilled laborer generally earns more (in the formal economy) than thirty percent of the population—a surprising statistic, though justifiable when considering formal unemployment estimates range from thirty to forty percent. In South Africa, the problem is not the inadequacy of a 'livable wage' (as it is in many developing countries); the problem is the number of jobs available. As Nattrass and Seekings conclude, "Most

¹⁰¹ Though it is uncertain how beneficial this spending was in the quality of service provided because most of was project related, i.e. spending on schools or water access, where efficacy is hard to assess. Nattrass and Seekings, p.57.

¹⁰² "Within group inequality among the black population now accounts for over two-thirds of inequality, whereas it only accounted for 38 percent in 1975." Nattrass and Seekings, p.49.

¹⁰³ Nattrass and Seekings, p.49. Deciles are formed by ranking national household income and dividing the data into ten groups of equal size. The first decile represents the ten percent of households with the least income, and the tenth with the greatest. Moving from households to the population is only approximate, especially because poorer households tend to have more people.

¹⁰⁴ One weakness of this argument, it must be conceded, is that this data reflect participation in the formal economy only. With roughly thirty-five percent unemployment, many of the households receive income from informal economic activity, which is notoriously difficult to obtain data for. However, I believe my interpretation of Nattrass and Seekings work remains valid.

Table 2.1: GEAR Prediction versus Actual Performance

Annual growth rates	1996	1997	1998	1999
Real GDP				
GEAR Prediction	3.5	2.9	3.8	4.9
Actual Performance	4.2	2.5	0	1.2
Private Investment				
GEAR Prediction	9.3	9.1	9.3	13.9
Actual Performance	6.1	4.7	-2.9	-4.4
Real wage growth (Private)				
GEAR Prediction	-0.5	1	1	1
Actual Performance	1.7	2.3	8.6	3
Employment (non-agricultural)				
GEAR Prediction	1.3	3	2.7	3.5
Actual Performance	-0.7	-1.7	-3.7	-3.2
Conventional deficit/GDP:				
GEAR Prediction	-5.1	-4	-3.5	-3
Actual Performance	-4.9	-4.6	-3.3	-2.6

Source: SARB, Quarterly Bulletin, March (2000), as quoted in Nattrass and Seekings, p.61.

poor households are poor because they have no access to wage income...the relationship between the lack of employment and poverty is much stronger in South Africa than in more developed countries.”¹⁰⁵

Using the empirical evidence one can conclude that for a development program to make a significant impact on inequality in South Africa it must focus on job creation rather than race-based initiatives. With an unemployment rate hovering around thirty-five percent, there is ample room for improvement. However, since 1994 the government strategy has failed to reduce unemployment. While intending job growth of up to three percent a year (see table 2.1), the neo-liberal GEAR policies actually have increased, rather than decreased unemployment. By one count, over 500,000 non-agricultural jobs were lost in the formal sector during the first three years of the Gear initiative (1996-1999).¹⁰⁶

¹⁰⁵ Nattrass and Seekings, p.54.

³³ Bond, p.41. In fairness, other reports state 400,000 jobs in the formal sector were lost. However, the SA Reserve Bank puts the figure at 490,000 between 1994 and 1999. Admittedly, some factors were beyond the control of the South African government, such as the Asian financial crisis and the tight monetary policy of the independent central bank. In fact, Boyd, Spicer and Keeton, attribute the loss of 200,000 jobs to the decline in the world gold price alone. See Boyd, Spicer, and Keeton, p.77.

One issue in securing wider employment is the current strength of the labor movement. While GEAR promised that wage agreements would be made more sensitive to “regional market conditions, [and] the diversity of skill levels in firms of varying size, location or capital intensity,” union strength has prevented this from happening.¹⁰⁷ One study showed how a ten percent increase in the union relative wage effect (the ability of unions to push their members’ wages above those of non-members) reduced employment by 5.6%.¹⁰⁸ According to the same study, if the union wage effect were reduced by fifty percent, then black employment overall would increase by about two percent, redistributing income from the upper-middle class African union workers to the lower-wage and marginalized poor who are not currently participating in the economy.¹⁰⁹

In fact, throughout the economy wages have been growing faster than the government anticipated (see table 2.1). The higher wages and lower employment levels have also meant that the productivity of labor has increased. Between 1994 and 1999, labor productivity growth exceeded four percent per annum, rates not equaled in South Africa’s recent history.¹¹⁰

Higher labor productivity has made the economy more capital-intensive, making the need for more investment ever more crucial for development. However, as Table 2.1 indicates, investment was another key area where government predications were overly optimistic.

South Africa’s inability to attract investment, both domestic and international, was one of the principle reasons behind the adoption of GEAR. By implementing the Washington Consensus-based, neoliberal growth strategy, the government intended to become a haven for capital in Africa, anticipating annual investment growth of over nine percent. In reality, as Table 2.1 shows, the tough choices required by the fiscal austerity were rewarded not with strong investment growth but rather with a decline in investment of nearly four and a half percent in 1999 alone.

¹⁰⁷ Department of Finance, *Growth, Employment and Redistribution*, as quoted in Natrass and Seekings, p.62.

¹⁰⁸ T.P. Schultz and G. Mwabu, “Labor Unions and the Distribution of Wages and Employment in SA,” *Industrial and Labor Relations Review*, 51 (4) 1998: 680-703. As cited in Natrass and Seekings, p.53.

¹⁰⁹ Natrass and Seekings, p.67. (Note 20)

¹¹⁰ Boyd, Spicer, and Keeton, p.77.

It was GEAR's failure to generate more investment that pushed South Africa to look at alternative explanations for the lack of investment. The evidence indicates South Africa faced difficulty because of the negative perceptions of Africa as a whole.¹¹¹ In cross-country studies, Africa overall, and South Africa specifically, does not attract the level of investment that the economic indicators alone would suggest; prompting researchers to label an 'African dummy' variable to explain the underinvestment.

Africa's exclusion for the world economy is well documented. According to the WTO, by 1999 Africa accounted for only 2% of all merchandise exports, down from 7.4% in 1948.¹¹² In 2000, Africa's share of world GDP was 3.2% while its population share was 12.2%.

For investments, the evidence is similarly bleak. Sub-Saharan Africa (including South Africa) as a whole received just over 3% of total FDI for low and middle-income countries during the 1990s.¹¹³ By 2000, Africa attracted just 0.7% of world FDI.¹¹⁴ For South Africa in particular, annual average FDI inflow between 1993 and 1998 amounted to only 1% of GDP (compared to Malaysia's 7% of GDP and Chile's 4% of GDP).

Of more concern, South Africa also suffers from the continent's problem of keeping investment in the country. One 1997 study, by Collier and Gunning, estimates that 37% of African investment is being held overseas, compared to just 3% in East Asia.¹¹⁵ Most tellingly, South Africa has had a net outflow of foreign direct investment since the end of apartheid.¹¹⁶

With South Africa unable to escape a regional indictment by investors, both domestic and international, the logical approach was to end the perceptions of inhospitable governance and investment environments in Southern Africa. If NEPAD reforms enough governments, investors will begin to differentiate between countries, and the 'Africa dummy' will fade away.

¹¹¹ Gelb, *NEPAD*, p.2.

¹¹² Michael Moore, Address to the 4th Ordinary Session of the OAU/AEC Conference of African Ministers of Trade. As quoted in Gibbs, p.11.

¹¹³ Gelb, *NEPAD*, p.22.

¹¹⁴ WTO, speech by Michael Moore at the conference on Developing Countries' Interests in the Millennium Round. As cited in Gibbs, p.12.

¹¹⁵ Gibbs, p.12.

¹¹⁶ Bond, p.141.

Because NEPAD remains in its implementation period it is too early to assess whether this strategy will succeed. The critical aspect appears to be the peer review mechanism. Investors are anxious to see how much leverage African governments are willing to give the collective body. Without strong measures for peer review, the visionary words of an African Renaissance will become hollow promises. Unfortunately, President Mbeki and President Olesugun's tentative response to the Zimbabwe elections last March do not bode well for an effective peer review system.

The Zimbabwe situation is a particular concern for South Africa because it is also affecting regional stability and economic growth. A central goal for South Africa of NEPAD is greater stability and sound governance in the Southern Africa region. Along with South Africa's regional agenda of pushing for greater regional integration within SADC, NEPAD is part of South Africa's political and economic investment in the region - an investment made to serve domestic political and economic goals.

The evidence supports this 'realist' interpretation of NEPAD and SADC integration. Since 1992, when South Africa formally joined SADC, regional trade and investment has thrived. Manufactured good exports to Southern Africa grew by 15.4% per annum between 1992 and 1996 in \$US terms, and those to the rest of Africa by an impressive 24.2% per annum.¹¹⁷ Altogether, there was a 52.6% increase in trade with Africa between 1994 and 1995, and by 1998 South Africa's trade surplus with Africa was over \$2.7 billion in 1998.

Moreover, South African investment flooded into the area. Before the 1994 election South Africa's foreign direct investment in Africa was around R3.7 billion. Soon after it had more than trebled, to R13 billion.¹¹⁸ Private South African companies such as Sasol, SABMiller and Standard Bank made substantial investments throughout the continent. South African Airways currently operates 70% of the routes in Africa and 40% of the traffic between Europe and Africa through its alliance with Swissair. MTN, a South African cellular network provider, recently invested \$425 million in a Nigerian cell-phone network.¹¹⁹

¹¹⁷ As cited by Gelb, *NEPAD*, p.14.

¹¹⁸ Vale and Maseko, "South Africa and the African Renaissance."

¹¹⁹ Hawthorne, "The Selling of Mbeki's New Deal."

This economic engagement, as well as political leadership, is evidence of South Africa's acceptance of its role as regional hegemon. As Table 2.2 shows, the South Africa economy already overwhelms the region. Within SADC, for example, South Africa is home to 60% of the road network, 65% of the rail and 86% of the rail freight. South Africa's GDP is more than three-quarters of regional production.

Table 2.2: South Africa & SADC - Basic Economic Indicators

1995 (unless indicated)	South Africa	SADC	SA as % of SADC
Surface Area ('000 sq km)	1221	6932	18
Population (millions)	39	135	29
GNP (\$bn)	125	165	76
GNP per capita (\$)	3160	1225	258
Exports (\$bn)	27.9	40.3	69
Imports (\$bn)	30.6	44.6	68
Road Network (paved kms 1990)	51469	86000	60
Rail network (kms 1990)	23507	36000	65
Harbor traffic (mn tons 1991)	104.6	116	90
Rail freight (mn tons p.a., 1988-90)	183.4	214	86

Note: SADC refers to the 12 member countries of SADC prior to Seychelles and the Democratic Republic of Congo joining in September 1997.

Source: Gelb, NEPAD, p.14.

While the numbers appear impressive, critics argue the rapid increase was a once off, end-of-apartheid splurge. They insist that African states remain economically unsound and politically ungovernable. Moreover, the recent flood of South African imports and investment in the region has created tension within the SADC community, as accusations of neo-mercantilism poison relations. Combined with South Africa's reluctance to provide public goods, such as absorbing immigration and enforcing established codes of conduct (i.e. Zimbabwe), some contend South Africa has no intention of becoming a regional hegemon.

However, this view ignores the underlying incentives for regional integration under hegemonic stability. For South Africa, with its high wages and relatively

productive labor force the advantages are substantial. While it has diversified its exports some over the last decade (See Appendix), it remains an economy based on mineral production. By further lowering regional trade barriers and promoting greater regional integration, South Africa can create jobs by becoming the beneficiation point for the region's primary goods.

For the other SADC countries, the increased trade and access to crucial foreign investment can meet growth requirements that would be unattainable in the domestic pool of resources. With the continuous calls for increased investment and trading opportunities, it seems illogical for the SADC community to oppose South Africa's economic interest in the region. However, regional governments argue that South Africa is merely replicating the inequality of the global economy on a regional basis.

Some of their points remain valid. There is a tremendous disparity in regional trade. In 1999, for example, South African imports from SADC amounted to R2.6 million and its exports were R17.7 million.¹²⁰ Yet, South Africa appears aware of the growing resentment in the region, and the need for more symmetrical growth. As one official from the South African Department of Foreign Affairs remarked, "Usually diplomats try to find exporting opportunities for their home industries. South Africa must be the only country in the world where diplomats [in the country's African missions] try to find *importing* opportunities."¹²¹ Moreover, within SADC, South Africa has agreed to lower its own trade barriers faster than lesser-developed countries.

It seems clear South Africa has made the decision that development will come collectively for the region if it comes at all. The time and resource investment in NEPAD and SADC indicate South Africa's commitment to the African continent. Economically, this makes sense. In order to sustain the rapid growth in exports since the end of apartheid, South Africa must ensure the health and growth of regional markets. South Africa's comparative advantages in infrastructure and skilled-labor, in contrast to the region's abundance of relatively cheap, less productive labor, can make trade mutually beneficial. Furthermore, regional development will help to end the collective stereotype of an ungovernable continent, and allow for greater participation in the global economy.

¹²⁰ *South African Yearbook of International Affairs* 2001/02 (The South African Institute of International Affairs: Jan Smuts House, Johannesburg, 2001), p.80.

For South Africa, the challenge remains convincing the other states in the region that the rising tide will raise all boats. Whether growth will be seen as a partnership or exploitative hegemonic relationship depends on how carefully South Africa nurtures Southern African political relationships (one possible explanation for the passive, 'quiet diplomacy' approach to the Zimbabwe crisis) as well as provides for symmetrical economic growth. In addition, it must be willing to pay the public goods, such as absorbing regional refugees and bankrolling regional security and development programs. If done correctly, South Africa's commitment to the regional could end the vicious cycles of poverty and finally establish sustainable development in Southern Africa.

CONCLUSION

Nine years after the end of apartheid, many in South Africa have begun to ask where is the change? The nation continues to have deep divisions along racial and economic lines. The government's conservative fiscal and monetary policy must bear some of the blame for the half-million jobs that have been lost since the end of apartheid. Despite the stifling austerity programs, the country continues to have net outflows of much needed foreign direct investment. Where is the change?

This view fails to properly account for the social, economic and political realities that the new government inherited in 1994. The systematic disenfranchisement of over eighty percent of the population left massive inequality in the populace, poor qualifications in the labor force, structural unemployment, and a bloated central government. The economy had been in recession for four consecutive years, the budget deficit was almost nine percent, and inflation was at fourteen percent.

By nearly all accounts, the economy is much healthier than in 1994. Deficits have been reduced. The double-digit inflation that ate away growth through the 1980s is beginning to come under control. Gold exports have been reduced from 36.1% of total exports to 21.5%, while beneficiated products rose from 23.3% to 27.8%, and

¹²¹ As quoted in *South African Yearbook of International Affairs* 2001/02, p.80. Emphasis included.

manufactured products rose from 5.6% to 17%. In 2002, gross fixed capital formation grew by almost 8% and manufacturing grew by 5.4% - its fastest growth since 1995.

The GDP is estimated to have grown 3.1% in 2002, making South Africa one of the best performing countries in the world last year. As President Mbeki reminded the country in his State of the Nation Address, 2002 was the tenth consecutive year of positive growth, a remarkable achievement considering the international turbulence over the last decade.¹²²

Moreover, South Africa is doing the right things for continued growth. Education investment, cited by new growth theory to be a crucial early indicator of long-term growth, has been consistently over one-fifth of the national budget - one of the highest rates in the world. In his 2003 Budget Speech Trevor Manuel reaffirmed this continued commitment to education, "Our future is in the hands of our children. Education expands abilities and opportunities. It is a great freedom in itself, and opens the doors to other freedoms. We recognise this. That is why, at 23,2 per cent of non-interest expenditure, investment in education and deepening of the skills base of the economy is our largest expenditure area."¹²³

South Africa is just beginning to reap the benefits of the difficult fiscal austerity and tight monetary policies. Trevor Manuel's 2003 Budget Proposal increases government spending by 6.8%, with nearly sixty percent of all non-interest government expenses going to health, education, welfare, housing, and other social services.¹²⁴ Government spending will also increase for the crucial job creation segment, building on the employment growth recorded in the third quarter of 2002 - the first increase in six years.

While following some of the Washington Consensus formula, South Africa's development program is closer to new growth theory than orthodox neoliberalism. The government has repeatedly shown it is willing to intervene in the markets to protect national interest. The strict capital controls, only liberalized with the 2003 Budget are a prime example, in addition to the slow privatization of state assets. Active investment in

¹²² Thabo Mbeki, "State of the Nation Address of the President of South Africa," Houses of Parliament, Cape Town, February 14, 2003. Online, <http://www.polity.org.za>.

¹²³ Manuel, Trevor, "Budget Speech By Minister of Finance TA Manuel," February 26, 2003. Online, <http://www.polity.org.za>.

human capital creation, through training and education, has been at the core of government spending.

Politically, the increased international standing of South Africa and President Mbeki has yet to yield measurable results. However, South Africa's prominence in nearly all issues surrounding the developing world is confirmed by its continued role in various international forums, including President Mbeki's current role as head of the African Union. As NEPAD has shown, South Africa is well positioned to shape the development agenda regionally, on the continent, and globally.

In sum, South Africa's development policies have been a remarkable success. The ANC has been able to navigate a successful course between domestic pressures from the left (to increase spending irresponsibly) and international pressures from the right (to neglect social aspects of development, open capital markets, and sell off state assets more rapidly) to establish a secure foundation for a lasting, sustainable development.

University of Cape Town

¹²⁴ Manuel, *2003 Budget Speech*.

CHAPTER THREE: FROM HERE TO THERE

I return now to the questions that opened this paper: Why have most countries in Sub-Saharan Africa not progressed further? What causes countries to develop? What can be done?

The title of this paper, *Development Solutions in a Post-Consensus World*, is a deliberate play on the one enduring theme of developmental economics: the unrelenting optimism (hubris?) of researchers and academics in the field. Since the 1950s, recommendations have shifted wildly, yet each time proponents wrote that new hope was just around the corner. If anything has been learned, it is that there are no 'solutions' to the development problems in the cut and paste sense. Yet this is the limited approach that too many in the field, especially those with power, maintain. Similarly, as long as the World Bank and the IMF cling to these neoliberal policy proscriptions, we are certainly not in a post-Consensus world. This paper follows the tradition of development literature by maintaining hope, albeit tempered by the mixed record of history and the current geopolitical power dynamics.

My central argument has been that the current development paradigm, in that it is dictated by the Bretton Woods institutions and unrelentingly follows the Washington Consensus proscriptions of macroeconomic discipline, privatization, and liberalization, has impeded growth. Rather than serving the developing countries, the current system is the product of the World Bank and IMF's successful effort to expand their authority, as shown by their power to dictate domestic economic policy to much of the developing world. The formula itself is simultaneously too simplistic and too limited. It fails to incorporate developments from political economy – namely, the need to contextualize what in the abstract is the sound economic advice into the larger social and political environments of the developing world – as well as to acknowledge the last decade of

development theory, in which new evidence from country experiences has led to renewed emphasis on state involvement in the economy.

Without entirely disregarding the sound economic principles of the Washington Consensus, I suggest six areas of improvement.

- First, **the African community must seize control of development theory and policy itself.** Policies imposed, or seemingly imposed, from Washington will never be as successful as programs that have local ownership. As local governments are in a much better position to assess the impact of their actions, policies emanating from Africa governments themselves will take better account of the social costs of macroeconomic discipline and may adjust accordingly. With NEPAD and the AU, this process has already begun, but securing greater debt relief and macroeconomic control over domestic economies for African states should be a development priority.
- Accordingly, **development policy should follow the recommendations of African economists in support of an agricultural led growth.** Enhancing agricultural productivity by empowering farmers with ownership and technology would improve yields. More crucially, ending the hypocritical unilateral liberalization of world markets is essential to improve production and expand the economic sector that already provides over half of the continent's jobs and a third of its productive output. Ending agricultural subsidies in the North should be a vital component of any continental economic development effort.
- A third area for improvement in current development policies is a **greater emphasis on building national unity and solidifying governments.** Throughout Sub-Saharan Africa nation states are divided along religious, ethnic, and lingual lines. Without a common national purpose, groups and their representatives in government pursue destructive policies without regard to the future. The proven relationship between social cohesion and economic growth supports greater attention to this area.
- On a similar note, **development must have better recognition of the institutional surroundings in developing countries.** Attention should be given to establishing societal conventions that can support meaningful reforms.

Building national unity is one aspect, but the institutions must be more comprehensive, everything from mutual respect by individuals to valuing education. More tangibly, securing firm property rights and the rule of law, proven to be two institutions that are definite preconditions for sustainable development, should be a focus.

- A fifth crucial area rests with the international community, which **must provide better incentives for growth**. By continuing to support illegitimate governments that have poor policies, international institutions and aid organizations give little reason for reform. They must strengthen governments that show a willingness to reform and show greater selectivity in administering funds.
- Lastly, **the current Washington Consensus dominated paradigm must acknowledge the driving forces of economic growth**. In addition to growth through agriculture, investments should be made in productivity growth. Promoting more spending in education and training, even at the expense of short-term fiscal discipline, should be encouraged. The evidence from the past thirty years shows productivity growth to be far and away the leading cause of economic growth.

In the face of twenty years of economic stagnation throughout Sub-Saharan Africa, South Africa's remarkable recovery from apartheid is call for reform. South Africa has maintained economic growth for each of the last ten years. The surprisingly healthy economy (in light of the realities inherited by the new government in 1994, including the lingering unemployment rate of around 30%) seems primed for continued success (if it is not derailed by the very real, and significant, threat of HIV/AIDS) and more significant growth in the near future. Despite the qualifications and caveats, South Africa has given Sub-Saharan Africa its' first large scale successful development template to replace the unfulfilled promises of the Washington Consensus.

Unlike its neighbors, South Africa's policies have originated domestically. While unquestionably using the broad strokes of the Washington Consensus, they have differed in essential ways. South Africa was able to dictate the pace and sequencing of macroeconomic reforms, easing the deficit reduction over a five-year period and

gradually selling state assets through a privatization program. The government invested in both building national unity and enhancing productivity through education and training. The government maintained an independent judiciary, strengthened domestic institutions and confirmed the absolute rule of law from the outset in 1994.

More fundamentally, South Africa has succeeded because of good governance. The ANC used the extraordinary opportunity created by the end of apartheid to take a long-term perspective. The unique circumstances allowed the ANC to endure the short-term political costs associated with Consensus policies. With overwhelming public support, unlike any other government on the continent, the ANC could successfully implement sound policies without fearing electoral defeat. Moreover, they started with a clean slate internationally, allowing them to pace their reforms on their own timetable, rather than that of the World Bank or IMF. The result was an enhanced, socially aware neoliberal program skillfully piloted between the Scylla and Charybdis of the domestic progressive forces in South Africa (pushing for unsustainable increases in social spending) and the conservative international forces (pushing for destabilizing privatization and capital market liberalization programs).

Without systematic political reform on the continent, however, no other Sub-Saharan African country will be follow the template provided by South African. Economically, most African countries are locked into debt-cycles and structural adjustment programs with the IMF. Politically, most states are relatively weak and decentralized. What other government in Africa would be able to absorb the loss of half a million jobs and remain confident of reelection the following year? South Africa's good governance was only allowed because of its political stability, a luxury not enjoyed in many parts of the continent.

For development to occur, utilizing the strategies written above, reform-minded governments must be given the capacity to enact change. South Africa's advocacy of NEPAD and the AU, by establishing the regional and continental support structures for reform, is crucial to this process but more work must be done.

Moving forward, more research is needed on how to identify and then empower reform-minded governments. Developing institutions, building national unity, aligning incentives and focusing on African contributions to development are all contributory

policies, but they remain predicated on governments having the capacity for reforms. Development theory has progressed from viewing markets as isolated from their political and societal contexts to seeing markets as embedded in larger structures, but now it must focus more on the nature of governance itself in developing countries. What is the nature of political authority in developing countries? How are domestic institutions strengthened? How can stable, reform-oriented governments develop from fragmented societies?

These questions should be part of the continued effort to find better solutions for development. With implications ranging from eliminating poverty and enhancing opportunities for millions, to increasing global security and prosperity, it is not an overstatement to say the future depends on better strategies for economic development. Abandoning the project is not an option.

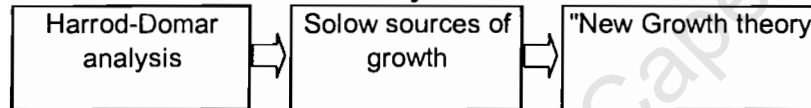
University of Cape Town

Appendix A: The Evolution of Development Thought

Goals of Development



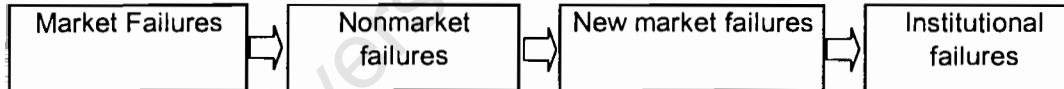
Macroeconomic Growth Theory



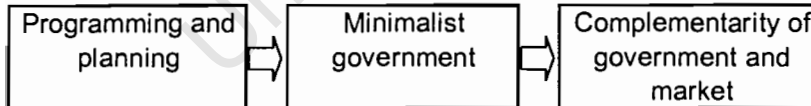
Capital Accumulation



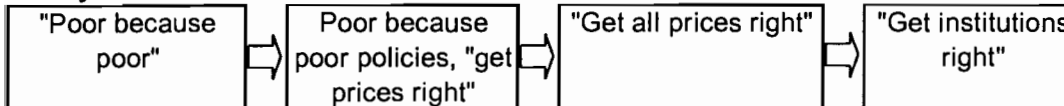
State and Market



Government Interventions



Policy Reform



Source: Frontiers of Development Economics, Gerald M. Meier and Joseph E. Stiglitz, eds.

Appendix B: Mineral Reserves and Export Diversification

Changing Composition of South Africa's Export Basket: 1988/1989-1995/1996

Export	Percent of Total Exports	
	1988/1989	1995/1996
Gold	36.1	21.5
Primary Products	20.3	19.4
*Beneficiated primary products	23.3	27.8
*Material-intensive products	4.9	7.1
*Manufactured products	5.6	17
Unclassified	9.8	7.2
Total	100	100

Source: Pieter Laubscher, "South Africa's Manufacturing Exports: Recent Market Trends," Trade and Industry Monitor⁴ (December 1997); 2. As quoted in Francis Wilson, Minerals and Migrants, p117.

South Africa's Mineral Reserves and Production, 1997

Mineral	Percent of World Production	World Rank
Alumino Silicates	61	1
Chrome Ore	46	1
Ferrochromium	45	1
Gold	20	1
Platinum Group Metals	47	1
Vanadium	57	1
Vermiculite	44	1
Titanium Minerals	24	2
Zirconium Minerals	29	2
Ferromanganese	12	3
Fluorspar	5	3
Manganese Ore	15	3
Antimony	3	4
Coal	6	5
Diamonds	9	5
Ferrosilicon	4	6
Silicon Metal	4	7
Aluminum	3	8
Iron Ore	3	8
Lead	3	8
Nickel	3	8
Uranium	4	8
Asbestos	2	9
Phosphate Rock	2	9
Copper	2	12
Silver	1	15
Zinc	1	17

Source: South African Yearbook 1999 (Pretoria: Government Communication and Information System, 1999), 102-3. As quoted in Francis Wilson, Minerals and Migrants, 116.

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University of Cape Town